Single Audit Report

2012-13

Edmund G. Brown Jr.
Governor

State of California

DEPARTMENT OF
FINANCE
OFFICE OF THE DIRECTOR

EDMUND G. BROWN JR. • GOVERNOR
STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

June 4, 2014

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, 2013. 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 four material weaknesses, one significant deficiency, and one instance of noncompliance 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.

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 Rick Sierra, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,

MICHAEL COHEN
Director

Enclosure

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Overview of California's Economy

Fiscal Year 2012-13

Overall, the economy is expected to improve, with slow and steady growth over the next three years Unemployment rates for the nation and California continue to drop, with job creation and housing prices improving

Unemployment is falling, jobs are being created, and consumer confidence is improving The federal government shutdown in 2013 and the uncertainty created by policy disagreements in Congress muted real GDP growth However, the growth is expected to pick up in 2014 to around 2 5 percent before increasing to over 3 percent in 2015 and 2016

The national unemployment rate decreased to 6 7 percent in December 2013, down from 7 8 percent at the end of 2012 Job growth has been fairly robust, with an average of 194,000 jobs added per month through 2013 Although there have been ups and downs, this means the nation has recovered almost all of the jobs lost during the recession The increased labor force from new entrants has kept the unemployment rate elevated There are very few signs of wage pressures that might lead to increased inflation, which is forecast to remain below 2 percent through 2015

Consumption continues to be the main driver of growth for the economy, with purchases of durable goods rising strongly over the past few years This will likely slow over the forecast period as pent-up demand following the recession trails off Private domestic investment, such as purchases of producers' equipment, has been increasing faster than the rate of consumption, and should add to GDP growth over the forecast period After a number of years of the government sector cuts, government expenditures are not expected to decrease overall GDP growth However, net exports continue to be a drag on growth, as import growth outpaces export growth

California's recovery spread to more sectors of the economy in 2013 The unemployment rate fell more quickly than the national rate, to 8 3 percent in December 2013 from 9 8 percent at the end of 2012 The labor force participation rate, which measures the number of employed and unemployed job-seekers as a percent of the population above 16 years of age, remained steady For California, the labor force is expected to expand slowly despite the retirement of the baby boomer cohort The jobs lost during the recession are not forecast to be recovered until the end of 2014, and the unemployment rate is not expected to drop below 7 percent until the middle of 2016 Given the slack in the job market, overall inflation is expected to remain below 2 percent in California for the next few years

Job growth has been relatively robust in 2013, and California should continue to add jobs at around 2-percent annual growth rate (around 340,000 jobs a year) through 2016 Goods-producing jobs, such as in construction and manufacturing are growing at a slower rate than service-providing jobs Of these, professional and business services jobs (including high technology jobs such as computer systems design and research and development), educational and health services jobs, and leisure and hospitality jobs should be added at a higher rate Government jobs will begin to grow slowly after a number of years of cuts As retirements increase, the need for highly skilled workers to replace retirees will also increase, as will the need for more health care professionals

The housing market has been recovering, with prices of existing single-family homes up roughly 20 percent in December 2013 compared to December 2012 The supply of homes for sale has remained low, with the median number of days to sell at around 30 through most of 2013, close to the same length of time as in 2005 Part of the explanation is that the home-ownership rate has fallen, to around 55 percent in 2012 versus a high of 60 percent in 2006 As California has a high proportion of renters, and average housing costs remain high, measurements of the poverty rate have been rising If consumers have difficulties saving for a down payment given the slowly improving job market, the trends in favor of multi-family housing may continue for some time

Given the slow pace of the U S recovery so far, there are some risks to consider   First, the persistence of unemployment has meant slow income growth for a broad section of the population The large numbers of job-seekers hold down wage growth for employees This impacts the ability of people to save and invest, making it harder to buy homes and build up retirement accounts The stock market growth in 2013 may have helped mitigate some of the decreased savings, but many retirees, particularly ones who were forced to retire early, may be living on reduced incomes The U S economy is still very dependent on consumption, and lower incomes for large segments of the population will dampen future growth

Second, economic expansions do not last forever In the post-war period, the average expansion length is almost five years and the longest expansion was ten years As of December 2013, the current expansion has lasted four and a half years While there are few signs of inflation or tight supply conditions that would trigger a contraction, it would be very unusual for the U S not to see another recession before 2020

Part One

State of California Financial Report for the Year Ended June 30, 2013

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California State Auditor

Elaine M. Howle State Auditor
Doug Cordiner Chief Deputy

Independent Auditor's Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

Report on the Financial Statements

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, 2013, and the related notes to the financial statements, which collectively comprise the State's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 86 percent of the assets and deferred outflows, and 32 percent of the revenues of the business-type activities.

- The University of California and the California Housing Finance Agency that represent 93 percent of the assets and deferred outflows, and 92 percent of the 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.

- The Golden State Tobacco Securitization Corporation, the Public Employees' Retirement, the State Teachers' Retirement, the State Water Pollution Control, and the 1943 Veterans Farm and Home Building funds, that represent 85 percent of the assets and deferred outflows, and 51 percent of the additions, revenues and other financing sources of the aggregate remaining fund information.

- The discretely presented component units noted above.

The related 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. The financial statements of the Golden State Tobacco Securitization Corporation, the Public Building Construction, the Public Employees' Retirement, the State Lottery, the Water Resources and the 1943 Veterans Farm and Home Building funds were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall financial statement presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United State of America require that the 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. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's basic financial statements. The introductory section, combining financial statements, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining financial statements are the responsibility of management and were derived from, and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 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 basic 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 above, 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.

Other Reporting Required by Government Auditing Standards

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* in considering the State's internal control over financial reporting and compliance.

CALIFORNIA STATE AUDITOR
John F. Collins II
JOHN F. COLLINS II, CPA
Deputy State Auditor

April 16, 2014

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, 2013. There were significant accounting changes and restatements in fiscal year 2012-13 which are described in Note 1L. All comparisons between fiscal year 2012 and 2013 are based on restated amounts for fiscal year 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 2012-13 fiscal year, California made solid economic progress and ended on more stable fiscal footing. The State's general revenues increased by $14.6 billion (13.9%) over the prior year. Expenses for the State's governmental activities also increased but were less than revenues received, resulting in a $8.5 billion decrease in governmental activities' net deficit position. Total revenues and transfers for the State's business-type activities surpassed expenses by $1.4 billion in fiscal year 2012-13. Revenues exceeded expenses resulting in a 70.9% decrease in the total net deficit position for governmental and business-type activities over the 2011-12 fiscal year.

Net Position – The primary government's net deficit position as of June 30, 2013, was $4.1 billion. After the total net deficit position is reduced by $86.6 billion for net investment in capital assets and by $29.5 billion for restricted net position, the resulting unrestricted net position totals a negative $120.2 billion. Restricted net position is dedicated for specified uses and is not available to fund current activities. Almost half of the negative $120.2 billion consists of $59.1 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 position; however, local governments, not the State, record the capital assets that would offset this reduction.

Fund Highlights

Governmental Funds – As of June 30, 2013, the primary government's governmental funds reported a combined ending fund balance of $12.2 billion, an increase of $8.0 billion from the prior fiscal year. The unrestricted fund balance, comprised of committed, assigned, and unassigned balances, was negative $12.2 billion. The nonspendable and restricted fund balances were $155 million and $24.3 billion, respectively.

Proprietary Funds – As of June 30, 2013, the primary government's proprietary funds reported combined ending net position of $4.3 billion, an increase of $1.0 billion from the prior fiscal year. After the total net position is reduced by $1.8 billion for net investment in capital assets, expendable restrictions of $5.2 billion, and nonexpendable restrictions of $21 million, the unrestricted net position totals a negative $2.7 billion.

Noncurrent Assets and Liabilities

As of June 30, 2013, the primary government's noncurrent assets totaled $145.1 billion, of which $118.6 billion is related to capital assets. State highway infrastructure assets of $64.6 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled $164.3 billion, which consists of $80.1 billion in general obligation bonds, $31.7 billion in revenue bonds, and $52.5 billion in all other noncurrent liabilities. During the 2012-13 fiscal year, the primary government's noncurrent liabilities increased by $626 million (0.4%) over the prior fiscal year. This increase was primarily the result of a $3.5 billion decrease in loans payable, an increase of $3.3 billion in net other postemployment benefits obligations, an increase of $563 million for revenue bonds payable and an increase of $502 million 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 Position and the Statement of Activities.

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

- The *Statement of Activities* presents information showing how the State's net position changed during the most recent fiscal year. The State reports changes in net position 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 Position

The primary government's combined net deficit position (governmental and business-type activities) decreased by 70.9%, from $14.0 billion as restated at June 30, 2012, to $4.1 billion a year later.

The primary government's $86.6 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 position. 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 $29.5 billion of the primary government's net position 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 position. As of June 30, 2013, governmental activities reported an unrestricted net deficit of $117.4 billion and business type activities showed an unrestricted net deficit of $2.8 billion.

A large portion of the unrestricted net deficit of governmental activities consists of $59.1 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 position reported as "net investment in capital assets." Instead, the bonded debt is reported as a non-current liability that reduces the State's unrestricted net deficit. Readers can expect to see a continued deficit in the unrestricted section of net position 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 Position for the primary government.

Table 1

Net Position – Primary Government
June 30, 2012 and 2013
(amounts in millions)

	Governmental Activities		**Business-type Activities**		**Total**	
	2013	**2012**	**2013**	**2012**	**2013**	**2012**
ASSETS						
Current and other assets	$ 55,358	$ 52,262	$ 34,996	$ 35,025	$ 90,354	$ 87,287
Capital assets	108,668	104,757	9,959	8,871	118,627	113,628
Total assets	**164,026**	**157,019**	**44,955**	**43,896**	**208,981**	**200,915**
DEFERRED OUTFLOWS OF RESOURCES	**911**	**963**	**480**	**363**	**1,391**	**1,326**
Total assets and deferred outflows of resources	**$164,937**	**$157,982**	**$ 45,435**	**$44,259**	**$210,372**	**$202,241**
LIABILITIES						
Noncurrent liabilities	$ 128,052	$ 126,896	$ 36,282	$ 36,812	$ 164,334	$ 163,708
Other liabilities	44,863	47,587	4,616	4,763	49,479	52,350
Total liabilities	**172,915**	**174,483**	**40,898**	**41,575**	**213,813**	**216,058**
DEFERRED INFLOWS OF RESOURCES	**159**	**147**	**471**	**—**	**630**	**147**
Total liabilities and deferred inflows of resources	**173,074**	**174,630**	**41,369**	**41,575**	**214,443**	**216,205**
NET POSITION						
Net investment in capital assets	84,931	80,769	1,719	1,561	86,650	82,330
Restricted	24,316	24,872	5,172	4,593	29,488	29,465
Unrestricted	(117,384)	(122,289)	(2,825)	(3,470)	(120,209)	(125,759)
Total net position (deficit)	**(8,137)**	**(16,648)**	**4,066**	**2,684**	**(4,071)**	**(13,964)**
Total liabilities, deferred inflows of resources, and net position	**$ 164,937**	**$ 157,982**	**$ 45,435**	**$ 44,259**	**$ 210,372**	**$ 202,241**

Changes in Net Position

The expenses of the primary government totaled $224.9 billion for the year ended June 30, 2013. Of this amount, $115.5 billion (51.4%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $109.4 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of $119.3 billion were more than the residual expenses. As a result, the total net deficit position decreased by $9.9 billion, or 70.9%.

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

Table 2

Changes in Net Position – Primary Government

Years ended June 30, 2012 and 2013

(amounts in millions)

	Governmental Activities		**Business-type Activities**		**Total**	
	2013	**2012**	**2013**	**2012**	**2013**	**2012**
REVENUES						
Program Revenues:						
Charges for services	$ 23,102	$ 19,813	$ 28,379	$ 31,981	$ 51,481	$ 51,794
Operating grants and contributions	60,944	58,577	1,323	1,250	62,267	59,827
Capital grants and contributions	1,669	2,193	142	—	1,811	2,193
General Revenues:						
Taxes	118,645	104,256	—	—	118,645	104,256
Investment and interest	57	72	—	—	57	72
Miscellaneous	552	372	—	—	552	372
Total revenues	**204,969**	**185,283**	**29,844**	**33,231**	**234,813**	**218,514**
EXPENSES						
Program Expenses:						
General government	15,390	12,607	—	—	15,390	12,607
Education	50,586	51,288	—	—	50,586	51,288
Health and human services	94,070	89,940	—	—	94,070	89,940
Resources	5,671	5,951	—	—	5,671	5,951
State and consumer services	1,475	1,241	—	—	1,475	1,241
Business and transportation	12,836	13,720	—	—	12,836	13,720
Correctional programs	10,082	10,344	—	—	10,082	10,344
Interest on long-term debt	4,350	4,560	—	64	4,350	4,624
Electric Power	—	—	488	915	488	915
Water Resources	—	—	1,127	1,048	1,127	1,048
Public Buildings Construction	—	—	410	404	410	404
State Lottery	—	—	4,499	4,432	4,499	4,432
Unemployment Programs	—	—	17,599	21,112	17,599	21,112
California State University System	—	—	6,197	6,114	6,197	6,114
Nonmajor enterprise	—	—	140	184	140	184
Total expenses	**194,460**	**189,651**	**30,460**	**34,273**	**224,920**	**223,924**
Excess (deficiency) before transfers	**10,509**	**(4,368)**	**(616)**	**(1,042)**	**9,893**	**(5,410)**
Transfers	(1,998)	(2,031)	1,998	2,031	—	—
Change in net position	**8,511**	**(6,399)**	**1,382**	**989**	**9,893**	**(5,410)**
Net position, beginning (restated)	**(16,648)**	**(10,249)**	**2,684**	**1,695**	**(13,964)**	**(8,554)**
Net position (deficits), ending	**$ (8,137)**	**$ (16,648)**	**$ 4,066**	**$ 2,684**	**$ (4,071)**	**$ (13,964)**

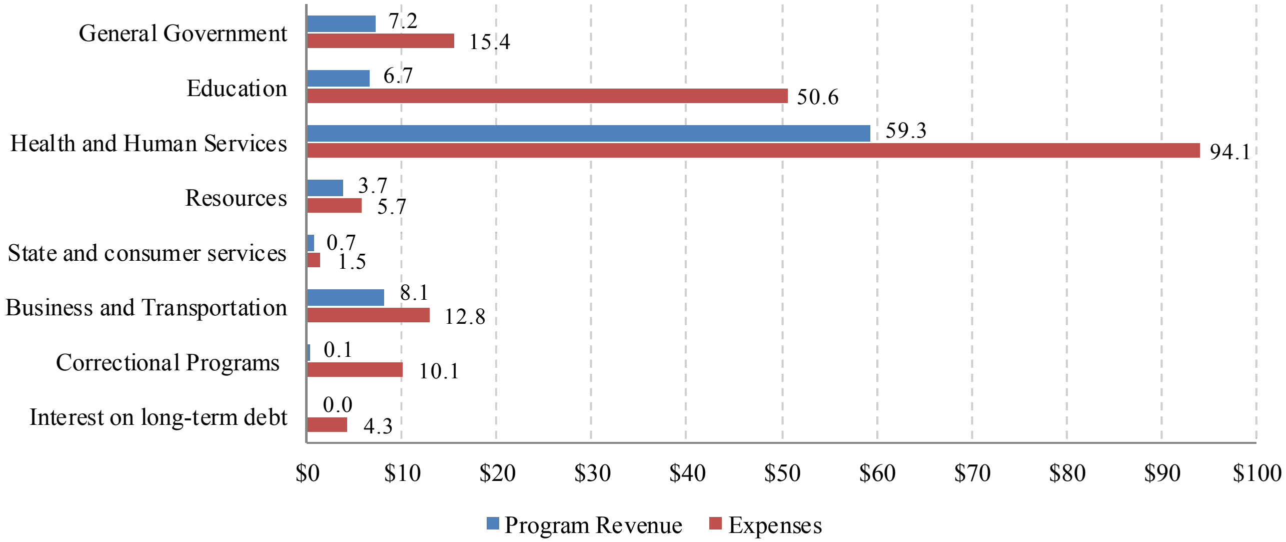
Governmental Activities

Governmental activities' expenses and transfers totaled $196.5 billion. Program revenues totaling $85.7 billion, including $62.6 billion received in federal grants, funded 43.6% of expenses and transfers, leaving $110.8 billion to be funded with general revenues (mainly taxes). General revenues for governmental activities totaled $119.3 billion and the governmental activities' total net deficit position decrease of $16.6 billion at the end of fiscal year 2011-12 to $8.1 billion for the year ended June 30, 2013, a decrease of $8.5 billion (51.1%).

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, 2013
(amounts in billions)



For the year ended June 30, 2013, total state tax revenues collected for governmental activities increased by $14.4 billion (14.6%) over the prior year. Personal income taxes increased by $13.1 billion (24.2%) as a result of improving California employment rates; the passage of Proposition 30, which increased personal income tax on earnings above $250,000 and increased capital gains taxes from a surging stock market; and increasing home prices. The state sales and use tax collection increased by $2.6 billion (8.4%) due to the 0.25% increase in the sales tax resulting from the passage of Proposition 30, increased consumer spending, increased consumer confidence in the improving economy, and a reduction in the unemployment rate which resulted in more disposable income for California households. However, corporate taxes decreased by $1.3 billion (15.5%).

Overall expenses for governmental activities increased by $4.8 billion (2.5%) from the prior year. The largest increase of expenditures, $4.1 billion (4.6%), was attributable to health and human services, the majority of which is attributable to the Department of Health Care Services, which includes Medi-Cal services. The 2012-13 fiscal year budget proposed an increase of $9.3 billion over the 2011-12 Budget for Medi-Cal services. The growth in spending for the Department of Health Care Services was due to an increased caseload, the increased utilization of services, and the rising costs of those services. General government expenditures increased by $2.8 billion (22.1%), the largest portion of which was attributable to Local Government financing.

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, 2013
(as a percent)

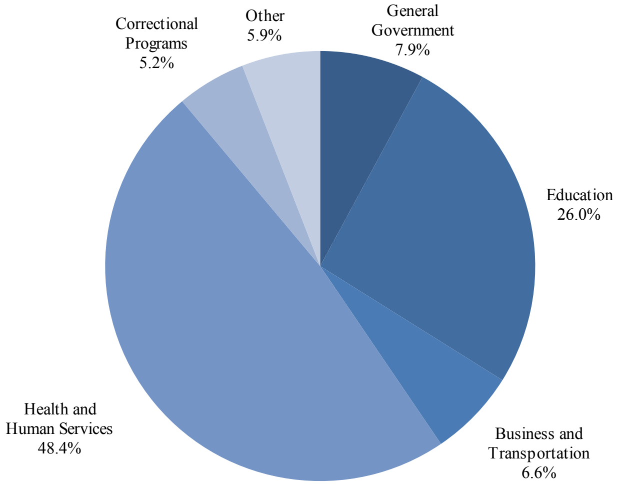
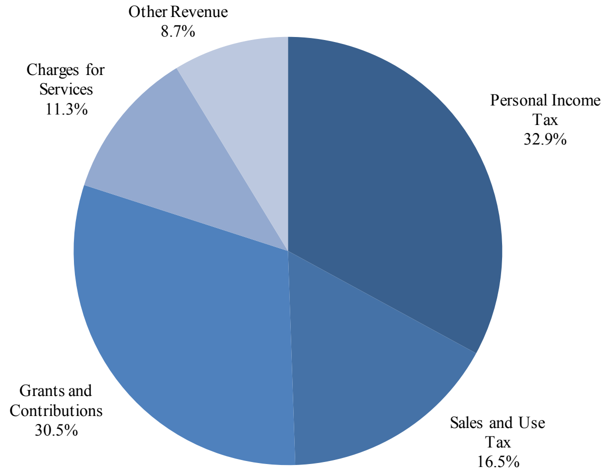


Chart 3

Revenues by Source
Year ended June 30, 2013
(as a percent)



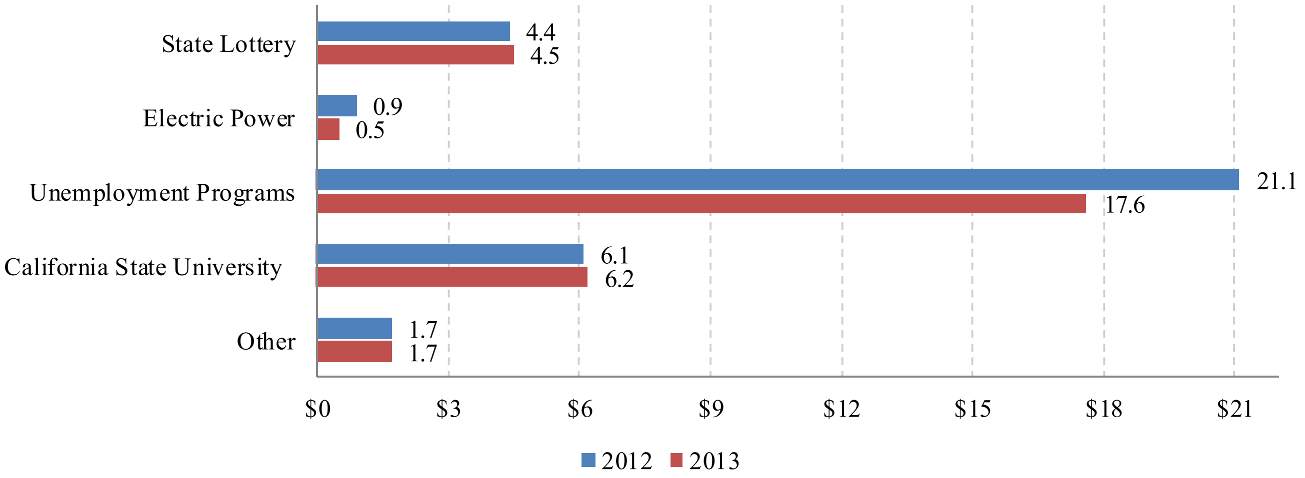
Business-type Activities

Business-type activities expenses totaled $30.5 billion. Program revenues of $29.9 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 position increased by $1.4 billion, or 51.5%, during the year ended June 30, 2013.

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
Years ended June 30, 2012 and 2013
(amounts in billions)



Fund Financial Analysis

The State's governmental funds had an $8.0 billion increase in fund balance over the prior year's restated ending fund balance. Some proprietary funds' net position increased, as their revenues exceeded expenses for the fiscal year 2012-13. The Unemployment Programs Fund incurred the largest decrease in net deficit position of $999 million.

Governmental Funds

The governmental funds' Balance Sheet reported $64.2 billion in assets, $51.9 billion in liabilities and deferred inflows of resources, and $12.2 billion in fund balance as of June 30, 2013. Total assets of governmental funds decreased by 1.7%, while total liabilities decreased by 18.6%, primarily resulting in a total fund balance increase of 8.0 billion (190.4%) over the prior fiscal year. This is the result of decrease in liabilities of governmental fund by $11.4 billion. In prior years, 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, 2013, long-term borrowing had decreased by $4.1 billion to $6.5 billion.

Within the governmental funds' total fund balance, $155 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, $24.3 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, of the total fund balance, $2.3 billion is classified as committed for specific purposes and $209 million is classified as assigned for specific purposes. The unassigned balance of the governmental funds is a negative $14.8 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds reports $204.9 billion in revenues, $202.1 billion in expenditures, and a net $5.2 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2013, was $12.2 billion, a $8.0 billion increase over the prior year's restated ending fund balance of $4.2 billion. The reason for the change in the fund balance was a net decrease in liabilities from the prior year.

Personal income taxes, which account for 56.9% of tax revenues and 32.9% of total governmental fund revenues, increased by $13.0 billion from the prior fiscal year. Sales and use taxes, which account for 28.6% of tax revenues and 16.5% of total governmental fund revenues, increased by $2.7 billion over the prior fiscal year. Corporation taxes, which account for 6.1% of tax revenues and 3.5% of total governmental fund revenues, decreased by $1.3 billion from the prior fiscal year. Governmental fund expenditures increased by $6.5 billion over the prior fiscal year. General obligation bonds and commercial paper of $4.0 billion were issued during the 2012-13 fiscal year; however, this was $127 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 $14.3 billion. The Federal Fund, the Transportation Fund, and the Environmental and Natural Resources Fund ended the fiscal year with fund balances of $198 million, $7.2 billion, and $7.8 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $11.3 billion.

General Fund: As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets and deferred outflows of resources of $15.6 billion; liabilities and deferred inflows of resources of $29.9 billion; and nonspendable, restricted, and committed fund balances of $140 million, $179 million, and $23 million, respectively, leaving the General Fund with a negative unassigned fund balance of $14.6 billion. Total assets and deferred outflows of resources of the General Fund increased by $1.3 billion (8.9%) over the prior fiscal year while the total liabilities and deferred inflows of resources of the General Fund decreased by $7.4 billion (19.9%). Total fund deficit decreased by $8.7 billion (37.9%).

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had an excess of revenues over expenditures of $9.3 billion ($99.4 billion in revenues and $90.1 billion in expenditures). Approximately 94.5% of General Fund revenue ($93.9 billion) is derived from the State's largest three taxes – personal income taxes ($66.2 billion), sales and use taxes ($20.4 billion), and corporation taxes ($7.3 billion). A total of $175 million in revenue is included in the General Fund in compliance with GASB, Statement 54. These revenues are not considered General Fund revenues for any budgetary purposes or for the Budgetary/Legal Basis Annual Report. Most of these revenues ($170 million) are from unemployment programs.

During the 2012-13 fiscal year, total General Fund revenue increased by $12.8 billion (14.8%). This is primarily a result of the net increase in personal income taxes of $12.6 billion (23.6%). Revenue from sales and use taxes also increased by $1.8 billion (9.7%) However, corporation taxes decreased by $1.3 billion (15.7%).

General Fund expenditures increased by $1.8 billion (2.1%). The largest increase was in general government program expenditures which were up $1.6 billion over the prior year. The General Fund's ending fund balance for the year ended June 30, 2013 was a negative $14.3 billion, a decrease of $8.4 billion from the prior year's restated ending fund deficit of $22.7 billion.

Federal Fund: This fund reports federal grant revenues and related expenditures to support the grant programs. The largest of these programs is health and human services, which accounted for $49.7 billion (80.4%) of the total $61.8 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 Federal Fund expenditures amounting to $6.6 billion (10.7%). The Federal Fund's revenues increased by $1.8 billion, which was approximately the same amount of increase in combined expenditures and transfers, resulting in a $37 million fund balance increase from the prior year's ending fund balance of $161 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 0.6% and expenditures increased by 3.2%. Other financing sources provided net receipts of $2.0 billion. The Transportation Fund ended the fiscal year with a $7.2 billion fund balance, an increase of $504 million 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 $440 million. The Environmental and Natural Resources Fund ended the fiscal year with a $7.8 billion fund balance, a decrease of $148 million (1.9%) from the prior year.

Proprietary Funds

Enterprise Funds: The total net position of the enterprise funds at June 30, 2013, was $4.1 billion—$1.4 billion greater than the prior year's restated ending net position of $2.7 billion. Some enterprise funds recorded an increase in net position during the 2012 13 fiscal year. The Unemployment Programs Fund had a decrease in its net deficit position of $999 million. The net position increased in Nonmajor Enterprise Funds ($203 million) and the Public Buildings Construction Fund ($198 million).

As shown on the Statement of Net Position of the proprietary funds, the total assets and deferred outflows of resources of the enterprise funds were $45.9 billion as of June 30, 2013. Of this amount, current assets totaled $14.1 billion, noncurrent assets totaled $31.3 billion and deferred outflows of resources totaled $480 million. The largest changes in asset account balances were a $1.6 billion increase in cash and pooled investments and a $834 million decrease in interfund receivables. The total liabilities and deferred inflows of resources of the enterprise funds were $41.9 billion. The largest liabilities of the enterprise funds are $24.1 billion of revenue bonds payable and $8.6 billion of noncurrent loans payable. During the 2012-13 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, 2013, was $8.6 billion.

Total net position consisted of four segments: a nonexpendable restricted net position of $21 million, a restricted expendable net position of $5.2 billion, net investment in capital assets of $1.7 billion, and an unrestricted net deficit of $2.8 billion.

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Position of the proprietary funds, the enterprise funds ended the year with operating revenues of $27.4 billion, operating expenses of $27.8 billion, and net expenses from other transactions of $311 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $18.6 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 $3.4 billion from $21.9 billion in fiscal year 2011-12. 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 $17.3 billion by the Unemployment Programs Fund and personal services of $3.8 billion by the California State University Fund.

Internal Service Funds: The total net position of the internal service funds was $252 million as of June 30, 2013. The net position consists of two segments: net investment in capital assets of $127 million and unrestricted net position of $125 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 position of $5.2 billion. The pension and other employee benefit trust funds ended the fiscal year with net position of $443.2 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net position of $21.2 billion. Agency funds act as clearing accounts and thus do not have a net position.

For the year ended June 30, 2013, the fiduciary funds' combined net position was $469.5 billion, a $41.7 billion increase from the prior-year net position. The net position increased primarily because contributions received and investment income in pension and other employee benefit trust funds exceeded payments made to participants.

The Economy for the Year Ending June 30, 2013

The U.S. economy completed its fourth year of recovery as California ended its fiscal year on June 30, 2013. National growth was slow, with real gross domestic product (GDP) up a modest 1.6%. Despite limited support from the rest of the country, a rebound in California's housing market, tourism, and other key sectors allowed the State to post a solid gain for the year.

California's total personal income reached $1.79 trillion in fiscal year 2012-13, accounting for more than one out of every eight dollars earned nationally. The state registered a 4.5% income rise during the year, beating the 3.5% rise in the nation as a whole.

Housing staged a sharp recovery, with a 33.5% surge in the median price of a single-family existing home over the 12 months ended June 2013. For the 2012-13 fiscal year, housing permits totaled 69,401 units, a 41.5% increase over the 49,041 permits issued in the prior year. Pent-up demand was evident in other areas as well. Auto sales, for example, increased sharply with registrations climbing 12.5% to 850,712 for the year in total.

California's job market improved significantly, with nonfarm employment in June 2013 220,000, or 1.5%, above the level of the prior year. Job gains were widespread, with particularly large numerical and percentage increases in construction, leisure and hospitality, business and professional services, education, and health care and social assistance. The public sector and manufacturing were the primary areas showing job losses. The general improvement in the labor market was strong enough to push the unemployment rate down more than two full percentage points, from 10.6% in June 2012 to 8.5% as of June 2013.

California ended its fiscal year on June 30, 2013, with solid economic progress. While more growth is needed to drive the jobless rate lower and improve incomes for all, substantial gains are being achieved.

General Fund Budget Highlights

The original General Fund budget of $97.6 billion was reduced by $720 million. This decrease is mainly the result of reductions in funding to education programs per Section 12.42 of the 2012 Budget Act, as well as other reductions in education and State and consumer services, and the increases in health and human services and other general government expenditures. The Judicial Branch absorbed $344 million of the increase in other general government expenditures. During the 2012-13 fiscal year, General Fund actual budgetary basis expenditures were $95.9 billion, $1.0 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, 2013
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 1,335	$ 682	$ (653)
Business and transportation	90	90	—
Resources	941	1,177	236
Health and human services	26,658	27,395	737
Correctional programs	8,821	8,700	(121)
Education	50,128	48,788	(1,340)
General government:			—
Tax relief	439	439	—
Debt service	4,436	4,439	3
Other general government	4,786	5,204	418
Total	**$ 97,634**	**$ 96,914**	**$ (720)**

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, 2013, amounted to $118.6 billion (net of accumulated depreciation). This investment in capital assets includes land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. Infrastructure assets, 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, 2013
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 17,602	$ 217	$ 17,819
State highway infrastructure	64,620	—	64,620
Collections – nondepreciable	23	6	29
Buildings and other depreciable property	25,614	11,264	36,878
Intangible assets – amortizable	986	174	1,160
Less: accumulated depreciation/amortization	(11,166)	(4,693)	(15,859)
Construction in progress	9,905	2,587	12,492
Intangible assets – nonamortizable	1,084	404	1,488
Total	**$ 108,668**	**$ 9,959**	**$ 118,627**

As of June 30, 2013, the State had $118.6 billion in net capital assets, of which $64.6 billion was state highway infrastructure. This total represents an increase of $2.1 billion in infrastructure capital assets from fiscal year 2011-12.

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 2012-13 fiscal year, the actual amount spent on preservation was 23.5% 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 49,718 lane miles and 13,071 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, 2013, the primary government had total bonded debt outstanding of $116.5 billion. Of this amount, $83.2 billion (71.4%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $83.2 billion of general obligation bonds is $5.2 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 $3.1 billion and the long-term portion is $80.1 billion. The remaining $33.3 billion (28.6%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.6 billion and the long-term portion is $31.7 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, 2013
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 79,306	$ 826	$ 80,132
Revenue bonds	7,581	24,079	31,660
Certificates of participation and commercial paper	530	77	607
Capital lease obligations	4,920	847	5,767
Net other postemployment benefits obligation	15,559	510	16,069
Proposition 98 funding guarantee	1,914	—	1,914
Mandated costs	6,697	—	6,697
Loans payable	—	8,585	8,585
Other noncurrent liabilities	11,545	1,358	12,903
Total noncurrent liabilities	128,052	36,282	164,334
Current portion of long-term obligations	4,182	2,244	6,426
Total long-term obligations	**$ 132,234**	**$ 38,526**	**$ 170,760**

During the year ended June 30, 2013, the primary government's total long-term obligations increased by $1.8 billion over the prior year's restated balance. Governmental activities net other postemployment benefits obligation had the largest increase ($3.1 billion), but other notable increases occurred in general obligation bonds payable, commercial paper payable, mandated costs, and capital lease obligations. The largest decrease was in loans payable ($3.5 billion). During the fiscal year, the State issued $3.3 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.

In January 2013, Standard and Poor's raised its rating on the State's general obligation bond 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 the next several years. During the fiscal year 2012-13, the ratings from the other two credit rating agencies remained unchanged as follows: Moody's Investors Service – "A1" and Fitch – "A-".

Recent Economic Condition and Future Budgets

Recent Economic Condition

California's economy continued to grow during the first six months of fiscal year 2013-14, which began on July 1, 2013. Employment expanded, the jobless rate fell, incomes grew, and the housing market strengthened. An improving economy also bolstered the State's financial position, with strong gains in the State's principal revenue sources.

During the first six months of fiscal year 2013-14, California added 153,000 to nonfarm payrolls. Compared with the prior year, nonfarm employment as of December 2013 was up by 236,000 jobs. The year-over-year 1.6% increase matched the gain recorded nationally.

California's jobless rate fell to a seasonally adjusted 8.3% in December 2013. This represented a 1.5 percentage point drop from the 9.8% recorded at the end of the prior year.

All major industry groups in the private sector added jobs in 2013. Construction hiring produced 29,000 new jobs in 2013, representing a gain of 4.8%. In contrast to the job gains in the private sector over the year, government payrolls contracted by 18,000, or 0.8%. Job losses occurred at the federal, state, and local level.

Total personal income in the State reached an annualized rate of $1.82 trillion in the third quarter of calendar year 2013, representing a gain of 3.4% over the prior year. Total wages and salaries advanced by 3.8%, while nonfarm proprietors' incomes jumped by 6.9%.

The housing market continued to strengthen in the July through December period of 2013. The supply of foreclosures and "short" sales (sales of homes at prices below the value of the mortgage) was at the lowest level since before the financial crisis of 2008. The median price of an existing single-family home reached $438,000 in California at the end of 2013, a gain of nearly 20% over the prior year's levels.

California's state coffers benefited from the economic gains as well as tax increases approved by voters in November 2012. Total General Fund revenues reached $42 billion in the first six months of fiscal year 2013-14. This represented a gain of $3.9 billion, or 10% over the first six months of the prior fiscal year. Personal income, sales taxes, and corporate revenues all contributed to the gain.

Risks, including higher interest rates, swings in stock prices, international instability, and the implications of California's drought persist; however, advances in technology, foreign trade, construction activity, and tourism bode well for the state's continued economic expansion.

California's 2013-14 Budget

California's 2013-14 Budget Act was enacted on June 27, 2013. The Budget Act appropriated $145.3 billion: $96.3 billion from the General Fund, $42.0 billion from special funds, and $7.0 billion from bond funds. The General Funds' budgeted expenditures increased $620 million (0.6%) over last year's General Fund budget. The General Fund's available resources were projected to be $97.1 billion, resulting in a projected reserve for economic uncertainties of $1.1 billion. General Fund revenues come predominantly from taxes, with personal income taxes expected to provide 62.6% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) are projected to supply approximately 95.1% of the General Fund's resources in the 2013-14 fiscal year.

Two years of significant reductions in state spending, combined with the first year of a temporary seven-year income tax increase and four-year sales tax increase, resulted in the State's most fiscally sound financial condition in over a decade. For the first time since fiscal year 2007-08, the State ended the prior fiscal year with a positive General Fund reserve balance, approximately $254 million, and is projected to end the 2013-14 fiscal year with a reserve balance of $1.1 billion. Two significant aspects of the 2013-14 fiscal year budget are the substantial allocation of General Fund money to education, $50.6 billion (52.5%), and Health and Human Services, $28.1 billion (29.2%).

The Budget increased K-12 funding levels, boosting spending per student by $1,045 in 2013-14 and by $2,835 through 2016-17. Also included was a one-time allocation of $1.25 billion for implementation of the Common Core State Standards in K-12 schools. The 2013 Budget addressed previous cuts to higher education by increasing funding between $1,649 and $2,491 per student through 2016-17.

The spending plan for fiscal year 2013-14 includes $20.7 billion of General Fund money for health programs. This $1.2 billion increase over 2012-13 primarily addresses implementation of the Patient Protection and Affordable Care Act (ACA), as well as increases in caseload and the need for health services. The State of California elected to expand Medi-Cal eligibility to include over one million adults with incomes up to 133% of the federal poverty level. Federal funds totaling $1.7 billion will also be directed to providing health coverage to the expanded Medi-Cal population.

Another significant area of General Fund expenditures is the State's Judiciary and Criminal Justice programs. The General Fund provided $9.2 billion for Corrections and Rehabilitation and $1.2 billion for the Judicial Branch. The Budget also reflects increased employee compensation costs. An increase of $600 million from prior year mirrors increased costs associated with the end of state employee furloughs in June 2013. New bargaining agreements reached in fiscal year 2013-14 resulted in salary increases for much of the State's workforce, and rising health care costs have necessitated the need for the State to pay increased premiums for 14 of the state's 21 bargaining units, as well as the State's managerial and supervisorial employees.

The fiscal year 2013-14 Budget is part of a multiyear plan that is balanced and maintains a reserve. Since the passage of this Budget Act, state revenues have exceeded estimates used in preparing the Budget. As of December 1, 2013, revenues were $270 million more than projected. At the same time, disbursements were $126 million below forecast. The State's budget picture, in terms of the difference between receipts and disbursements, was at least $396 million better than expected.

California's 2014-15 Budget

The Governor released his proposed 2014-15 Budget on January 10, 2014. The proposed budget continues Governor Brown's multi-year financial plan for the State of California that is balanced, maintains a $1.0 million reserve, contributes to the Budget Stabilization Account, and pays down budgetary debt from past years. For the second consecutive year, the General Fund will begin the fiscal year with a surplus rather than a deficit. The General Fund began with a surplus balance of $2.5 billion at the beginning of fiscal year 2013-14; it is projected to begin fiscal year 2014-15 with a surplus of approximately $4.2 billion. The 2014-15 Budget directs $1.6 billion to the Budget Stabilization Account, to prepare for the State's next budget shortfall, as mandated by Proposition 58, the California Balanced Budget Act, which was approved by voters in 2004. The 2014-15 Budget also honors the California Balanced Budget Act by directing $1.6 billion to retire the remaining Economic Recovery Bonds that were approved by voters in 2004 and removing that debt obligation. The improving economy will allow California to adhere to the mandates of Proposition 58 and still provide a surplus for the State's General Fund going into the 2015-16 fiscal year.

The 2014-15 Governor's Budget projects that General Fund revenues and transfers will be $104.5 billion and expenditures will be approximately $106.8 billion, with an estimated $1.9 billion year-end balance. Proposed 2014-15 General Fund revenues and transfers are 4.4% more than the revised 2013-14 estimate of $100.1 billion, while the 2014-15 expenditures are 8.5% greater than the revised 2013-14 estimate of $98.5 billion.

Personal Income Tax, which is projected to increase by $5.5 billion (8.5%) compared to the prior year, represents the major component of the $5.9 billion General Fund revenue increase. Projected increases in Sales and Use Tax of $1.2 billion (5.0%) and Corporation Tax of $0.7 billion (8.9%) also contribute to the 5.9% increase in General Fund Revenue projections. Reflecting the Governor's intent to reinvest in education, the fiscal year 2014-15 budget expenditures of $106.8 billion include $45.2 billion (42.4%) for K-12 funding and $12.4 billion (11.6%) for higher education programs. The increased funding of education is attributable to the passage, in November 2012, of the Governor's initiative, Proposition 30, Temporary Taxes to Fund Education. The funding level for K-12 students is estimated to increase by more than $2,188 per student in 2014-15 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. Medi-Cal, the budget's second largest program, is projected to increase spending 4.1% from $16.2 billion in 2013-14 to $16.9 billion in 2014-15. Growth in Medi-Cal General Fund expenditures has been reduced through the use of other funding sources, including the Gross Premiums Tax (authorized from 2009-10 to 2012-13), the Managed Care Organization Tax (authorized in 2013-14), the Hospital Quality Assurance Fee (first authorized in 2011-12), and Medicaid waivers that allow claiming of federal funds for state-only health care costs. In addition, the Medi-Cal program was expanded in two ways. The mandatory expansion simplified eligibility, enrollment, and retention rules, making it easier to get on and stay on the program. The optional expansion extended eligibility to adults without children and parent and caretaker relatives with incomes up to 138% of the federal poverty level.

According to the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, the State's budgetary condition is currently stronger than at any point in the past decade. The State's structural deficit has been corrected, with projected revenues greater than current spending commitments. Economic growth in future years is forecasted to continue. However, the LAO has stated that although the Governor's fiscal year 2014-15 budget projects a large surplus, the State's continued fiscal recovery is dependent on a number of assumptions, leaving open the possibility of an economic downturn and a return to operating deficits.

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.

Basic Financial Statements

Government-wide
Financial Statements

Statement of Net Position

June 30, 2013

(amounts in thousands)

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Current assets:				
Cash and pooled investments	$ 20,761,086	$ 5,368,975	$ 26,130,061	$ 2,068,054
Amount on deposit with U.S. Treasury	—	39,963	39,963	—
Investments	645,053	2,235,832	2,880,885	5,821,945
Restricted assets:				
Cash and pooled investments	—	3,199,349	3,199,349	90,659
Investments	—	—	—	11,636
Due from other governments	—	20,448	20,448	—
Net investment in direct financing leases	—	474,005	474,005	—
Receivables (net)	14,660,902	1,938,215	16,599,117	3,943,566
Internal balances	(486,406)	486,406	—	—
Due from primary government	—	—	—	209,125
Due from other governments	13,562,020	362,014	13,924,034	438,815
Prepaid items	109,692	50,937	160,629	1,168
Inventories	84,910	17,975	102,885	185,991
Recoverable power costs (net)	—	111,000	111,000	—
Other current assets	201,636	14,000	215,636	279,558
Total current assets	49,538,893	14,319,119	63,858,012	13,050,517
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,041,986	1,041,986	34,218
Investments	—	406,401	406,401	14,498
Loans receivable	—	325,930	325,930	—
Investments	—	1,268,777	1,268,777	24,510,217
Net investment in direct financing leases	—	7,519,404	7,519,404	—
Receivables (net)	1,971,742	303,120	2,274,862	1,424,281
Loans receivable	3,832,981	3,765,274	7,598,255	4,936,915
Recoverable power costs (net)	—	5,083,000	5,083,000	—
Long-term prepaid charges	14,264	930,066	944,330	17,728
Capital assets:				
Land	17,602,055	216,888	17,818,943	970,706
State highway infrastructure	64,619,437	—	64,619,437	—
Collections – nondepreciable	22,645	6,051	28,696	362,373
Buildings and other depreciable property	25,613,649	11,264,411	36,878,060	41,343,421
Intangible assets – amortizable	986,184	174,045	1,160,229	674,542
Less: accumulated depreciation/amortization	(11,165,562)	(4,693,059)	(15,858,621)	(18,892,317)
Construction in progress	9,905,330	2,587,131	12,492,461	2,917,542
Intangible assets – nonamortizable	1,084,328	403,979	1,488,307	5,131
Other noncurrent assets	—	32,830	32,830	333,470
Total noncurrent assets	114,487,053	30,636,234	145,123,287	58,652,725
Total assets	**164,025,946**	**44,955,353**	**208,981,299**	**71,703,242**
DEFERRED OUTFLOWS OF RESOURCES	**911,178**	**480,308**	**1,391,486**	**177,546**
Total assets and deferred outflows of resources	**$ 164,937,124**	**$ 45,435,661**	**$ 210,372,785**	**$ 71,880,788**

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

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
LIABILITIES				
Current liabilities:				
Accounts payable	$ 23,635,118	$ 557,290	$ 24,192,408	$ 2,442,417
Due to component units	209,125	—	209,125	—
Due to other governments	6,667,161	160,908	6,828,069	595
Revenues received in advance	1,417,508	292,745	1,710,253	1,057,211
Tax overpayments	5,780,193	—	5,780,193	—
Deposits	382,376	—	382,376	754,640
Contracts and notes payable	22	—	22	10,382
Unclaimed property liability	853,438	—	853,438	—
Interest payable	1,167,137	200,767	1,367,904	72,671
Securities lending obligations	—	—	—	1,468,772
Benefits payable	—	763,914	763,914	—
Current portion of long-term obligations	4,182,125	2,244,037	6,426,162	2,289,737
Other current liabilities	568,810	396,303	965,113	2,872,686
Total current liabilities	44,863,013	4,615,964	49,478,977	10,969,111
Noncurrent liabilities:				
Benefits payable	—	—	—	—
Loans payable	—	8,585,318	8,585,318	—
Lottery prizes and annuities	—	707,781	707,781	—
Compensated absences payable	4,115,601	189,208	4,304,809	249,007
Certificates of participation, commercial paper and other borrowings	530,499	77,220	607,719	63,170
Capital lease obligations	4,919,996	847,352	5,767,348	2,743,813
General obligation bonds payable	79,305,707	825,868	80,131,575	—
Revenue bonds payable	7,580,922	24,079,026	31,659,948	17,249,244
Net other postemployment benefits obligation	15,559,232	510,229	16,069,461	7,719,066
Pollution remediation obligation	973,957	15,107	989,064	66,523
Revenues received in advance	—	11,439	11,439	—
Other noncurrent liabilities	15,066,215	433,261	15,499,476	5,493,392
Total noncurrent liabilities	128,052,129	36,281,809	164,333,938	33,584,215
Total liabilities	**172,915,142**	**40,897,773**	**213,812,915**	**44,553,326**
DEFERRED INFLOWS OF RESOURCES	**158,942**	**471,436**	**630,378**	**34,056**
Total liabilities and deferred inflows of resources	**$ 173,074,084**	**$ 41,369,209**	**$ 214,443,293**	**$ 44,587,382**

(continued)

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

Statement of Net Position (continued)

June 30, 2013

(amounts in thousands)

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
NET POSITION				
Net investment in capital assets	$ 84,931,030	$ 1,718,648	$ 86,649,678	$ 12,477,905
Restricted:				
Nonexpendable – endowments	—	20,627	20,627	4,784,010
Expendable:				
Endowments and gifts	—	—	—	8,156,534
Business and transportation	10,085,253	6,663	10,091,916	—
Resources	5,737,364	788,558	6,525,922	—
Health and human services	2,850,447	150,776	3,001,223	—
Education	917,534	68,520	986,054	1,723,537
General government	3,913,748	658,461	4,572,209	—
Unemployment programs	—	3,433,770	3,433,770	—
State and consumer services	808,465	31,011	839,476	—
Correctional programs	3,102	14,156	17,258	—
Indenture	—	—	—	347,318
Statute	—	—	—	1,348,884
Other purposes	—	—	—	21,814
Total expendable	24,315,913	5,151,915	29,467,828	11,598,087
Unrestricted	(117,383,903)	(2,824,738)	(120,208,641)	(1,566,596)
Total net position (deficit)	**(8,136,960)**	**4,066,452**	**(4,070,508)**	**27,293,406**
Total liabilities, deferred inflows of resources, and net position	**$ 164,937,124**	**$ 45,435,661**	**$ 210,372,785**	**$ 71,880,788**

(concluded)

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

Statement of Activities

Year Ended June 30, 2013

(amounts in thousands)

		Program Revenues		
FUNCTIONS/PROGRAMS	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Primary government				
Governmental activities:				
General government	$ 15,390,100	$ 6,196,586	$ 1,026,673	$ —
Education	50,586,387	64,480	6,587,898	—
Health and human services	94,069,749	8,761,781	50,490,448	—
Resources	5,670,922	3,269,315	387,861	—
State and consumer services	1,475,486	682,503	35,515	—
Business and transportation	12,836,192	4,082,616	2,331,983	1,669,021
Correctional programs	10,081,736	45,153	83,158	—
Interest on long-term debt	4,349,632	—	—	—
Total governmental activities	194,460,204	23,102,434	60,943,536	1,669,021
Business-type activities:				
Electric Power	488,000	488,000	—	—
Water Resources	1,127,195	1,127,195	—	—
Public Buildings Construction	410,404	616,041	—	—
State Lottery	4,499,451	4,445,921	—	—
Unemployment Programs	17,599,219	18,597,962	—	—
California State University	6,196,541	2,891,432	1,323,345	481
High Technology Education	6,568	5,585	—	—
State Water Pollution Control Revolving	3,698	60,173	—	141,823
Housing Loan	70,356	66,050	—	—
Other enterprise programs	58,578	80,540	—	—
Total business-type activities	30,460,010	28,378,899	1,323,345	142,304
Total primary government	**$ 224,920,214**	**$ 51,481,333**	**$ 62,266,881**	**$ 1,811,325**
Component Units				
University of California	$ 27,630,059	$ 15,325,540	$ 7,655,258	$ 256,670
California Housing Finance Agency	432,710	39,976	38,624	—
Nonmajor component units	1,938,919	1,022,680	546,344	17,350
Total component units	**$ 30,001,688**	**$ 16,388,196**	**$ 8,240,226**	**$ 274,020**

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
Total general revenues and transfers
Change in net position
Net position – beginning
Net position (deficit) – ending

* Restated

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

Net (Expenses) Revenues and Changes in Net Position			
Primary Government			
Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
$ (8,166,841)		$ (8,166,841)	
(43,934,009)		(43,934,009)	
(34,817,520)		(34,817,520)	
(2,013,746)		(2,013,746)	
(757,468)		(757,468)	
(4,752,572)		(4,752,572)	
(9,953,425)		(9,953,425)	
(4,349,632)		(4,349,632)	
(108,745,213)		(108,745,213)	
	$ —	—	
	—	—	
	205,637	205,637	
	(53,530)	(53,530)	
	998,743	998,743	
	(1,981,283)	(1,981,283)	
	(983)	(983)	
	198,298	198,298	
	(4,306)	(4,306)	
	21,962	21,962	
	(615,462)	(615,462)	
(108,745,213)	**(615,462)**	**(109,360,675)**	
			$ (4,392,591)
			(354,110)
			(352,545)
			(5,099,246)
67,502,738	—	67,502,738	—
33,839,065	—	33,839,065	—
7,289,910	—	7,289,910	—
5,219,605	—	5,219,605	—
2,295,579	—	2,295,579	—
2,498,248	—	2,498,248	—
57,285	—	57,285	2,115,480
551,580	—	551,580	—
—	—	—	2,806,319
(1,997,759)	1,997,759	—	—
117,256,251	**1,997,759**	**119,254,010**	**4,921,799**
8,511,038	1,382,297	9,893,335	(177,447)
(16,647,998) *	2,684,155 *	**(13,963,843)** *	**27,470,853** *
$ (8,136,960)	**$ 4,066,452**	**$ (4,070,508)**	**$ 27,293,406**

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

Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2013
(amounts in thousands)

	General	Federal
ASSETS		
Cash and pooled investments	$ 847,892	$ 273,649
Investments	—	—
Receivables (net)	12,650,495	950
Due from other funds	764,705	—
Due from other governments	1,151,555	11,805,801
Interfund receivables	53,767	—
Loans receivable	165,643	186,236
Other assets	11,538	96,907
Total assets	**15,645,595**	**12,363,543**
DEFERRED OUTFLOWS OF RESOURCES	—	—
Total assets and deferred outflows of resources	**$ 15,645,595**	**$ 12,363,543**
LIABILITIES		
Accounts payable	$ 1,657,644	$ 1,229,107
Due to other funds	11,661,164	8,338,802
Due to component units	169,215	—
Due to other governments	703,684	2,498,737
Interfund payables	6,435,046	—
Revenues received in advance	717,370	76,533
Tax overpayments	5,780,193	—
Deposits	2,194	—
Interest payable	—	4,123
Unclaimed property liability	853,438	—
General obligation bonds payable	—	—
Other liabilities	550,494	18,288
Total liabilities	**28,530,442**	**12,165,590**
DEFERRED INFLOWS OF RESOURCES	**1,369,609**	—
Total liabilities and deferred inflows of resources	**29,900,051**	**12,165,590**
FUND BALANCES		
Nonspendable	140,107	—
Restricted	178,643	197,953
Committed	22,879	—
Assigned	—	—
Unassigned	(14,596,085)	—
Total fund balances (deficit)	**(14,254,456)**	**197,953**
Total liabilities, deferred inflows of resources, and fund balances	**$ 15,645,595**	**$ 12,363,543**

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

Transportation	Environmental and Natural Resources	Nonmajor Governmental	Total
$ 2,874,361	$ 5,795,662	$ 10,028,511	$ 19,820,075
—	—	645,053	645,053
1,060,292	505,457	2,296,978	16,514,172
1,165,809	437,182	1,385,006	3,752,702
78,522	56,924	461,258	13,554,060
3,610,076	535,477	1,668,970	5,868,290
—	1,023,710	2,457,392	3,832,981
86,567	—	6,624	201,636
8,875,627	**8,354,412**	**18,949,792**	**64,188,969**
—	—	—	—
$ 8,875,627	**$ 8,354,412**	**$ 18,949,792**	**$ 64,188,969**
$ 416,912	$ 328,034	$ 985,702	$ 4,617,399
167,876	16,766	2,103,637	22,288,245
909	2,011	36,988	209,123
450,840	26,668	3,040,211	6,720,140
2,648	10,979	6,117	6,454,790
60,155	143,835	89,586	1,087,479
—	—	—	5,780,193
4,518	325	374,578	381,615
—	—	126,633	130,756
—	—	—	853,438
—	—	500,470	500,470
284,387	7,918	156,323	1,017,410
1,388,245	**536,536**	**7,420,245**	**50,041,058**
256,685	**—**	**272,641**	**1,898,935**
1,644,930	**536,536**	**7,692,886**	**51,939,993**
—	—	15,022	155,129
7,190,847	6,962,098	9,786,372	24,315,913
49,410	863,648	1,404,977	2,340,914
—	—	209,171	209,171
(9,560)	(7,870)	(158,636)	(14,772,151)
7,230,697	**7,817,876**	**11,256,906**	**12,248,976**
$ 8,875,627	**$ 8,354,412**	**$ 18,949,792**	**$ 64,188,969**

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

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position

(amounts in thousands)

Total fund balances – governmental funds		**$ 12,248,976**
Amounts reported for governmental activities in the Statement of Net Position 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	17,599,743	
State highway infrastructure	64,619,437	
Collections – nondepreciable	22,645	
Buildings and other depreciable property	24,979,827	
Intangible assets – amortizable	927,119	
Less: accumulated depreciation/amortization	(10,636,790)	
Construction in progress	9,904,097	
Intangible assets – nonamortizable	1,054,970	
		108,471,048
• State revenues that will be collected after year end, but are not available soon enough to pay for the current period expenditures and therefore are considered deferred inflows of resources in the funds.		1,898,935
• 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 Position.		252,264
• Bond discounts and premiums are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Position.		(2,786,776)
• Deferred inflows and outflows of resources resulting from bond refunding gains and losses, respectively, are amortized over the life of the bonds are not reported in the funds.		825,043
• General obligation bonds and related accrued interest totaling $80,222,803, revenue bonds totaling $7,591,779, and certificates of participation and commercial paper totaling $538,593 are not due and payable in the current period and, therefore, are not reported in the funds.		(88,353,175)
• The following liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences	(3,956,714)	
Capital leases	(5,319,487)	
Net other postemployment benefits obligation	(15,193,946)	
Mandated costs	(6,696,590)	
Workers’ compensation	(3,059,052)	
Proposition 98 funding guarantee	(1,914,064)	
Net pension obligation	(3,278,775)	
Pollution remediation obligations	(1,009,216)	
Other noncurrent liabilities	(265,431)	
		(40,693,275)
Net position of governmental activities		**$ (8,136,960)**

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

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2013

(amounts in thousands)

	General	Federal
REVENUES		
Personal income taxes	$ 66,220,132	$ —
Sales and use taxes	20,429,772	—
Corporation taxes	7,261,910	—
Motor vehicle excise taxes	—	—
Insurance taxes	2,262,567	—
Other taxes	691,790	—
Intergovernmental	—	62,612,526
Licenses and permits	15,063	—
Charges for services	259,560	—
Fees	631,376	—
Penalties	151,782	30
Investment and interest	29,624	—
Escheat	551,580	—
Other	873,997	—
Total revenues	**99,379,153**	**62,612,556**
EXPENDITURES		
Current:		
General government	5,179,368	1,040,178
Education	41,556,256	6,587,056
Health and human services	28,164,652	49,667,993
Resources	1,144,918	364,516
State and consumer services	657,983	35,432
Business and transportation	5,978	3,895,122
Correctional programs	8,301,061	80,362
Capital outlay	710,440	—
Debt service:		
Bond and commercial paper retirement	1,297,473	70,990
Interest and fiscal charges	3,096,851	13,306
Total expenditures	**90,114,980**	**61,754,955**
Excess (deficiency) of revenues over (under) expenditures	9,264,173	857,601
OTHER FINANCING SOURCES (USES)		
General obligation bonds and commerical paper issued	—	—
Refunding debt issued	—	—
Payment to refund long-term debt	—	—
Premium on bonds issued	379,293	—
Remarketing bonds issued	—	—
Payment to remarketing agent	—	—
Capital leases	710,440	—
Transfers in	1,011,257	—
Transfers out	(2,890,451)	(820,967)
Total other financing sources (uses)	**(789,461)**	**(820,967)**
Net change in fund balances	8,474,712	36,634
Fund balances (deficit) – beginning	**(22,729,168)** *	**161,319**
Fund balances (deficit) – ending	**$ (14,254,456)**	**$ 197,953**

* Restated

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

Transportation	Environmental and Natural Resources	Nonmajor Governmental	Total
$ —	$ —	$ 1,204,444	$ 67,424,576
640,106	—	12,800,083	33,869,961
—	—	—	7,261,910
5,219,605	—	—	5,219,605
—	—	33,012	2,295,579
5,277	160,135	1,567,982	2,425,184
—	—	1,806,282	64,418,808
3,887,067	362,343	2,394,605	6,659,078
126,207	110,142	245,292	741,201
18,670	2,368,994	6,519,913	9,538,953
50,227	30,763	901,349	1,134,151
9,936	48,212	48,156	135,928
—	—	—	551,580
71,048	415,107	1,867,195	3,227,347
10,028,143	**3,495,696**	**29,388,313**	**204,903,861**
216,304	83,985	9,228,234	15,748,069
2,407	6,628	1,540,416	49,692,763
2,708	72,696	16,713,581	94,621,630
234,150	3,360,639	214,109	5,318,332
97,866	59,907	408,204	1,259,392
10,708,313	7,395	391,863	15,008,671
—	—	1,299,663	9,681,086
314	223,610	287,978	1,222,342
265,085	245,228	3,310,374	5,189,150
7,756	23,913	1,221,434	4,363,260
11,534,903	**4,084,001**	**34,615,856**	**202,104,695**
(1,506,760)	(588,305)	(5,227,543)	2,799,166
2,539,270	46,740	1,452,085	4,038,095
318,385	563,970	3,524,010	4,406,365
(101,880)	(405,160)	(2,440,605)	(2,947,645)
48,499	78,964	457,455	964,211
—	—	228,000	228,000
—	—	(226,968)	(226,968)
—	—	—	710,440
3,995	187,423	1,755,087	2,957,762
(797,402)	(31,984)	(357,950)	(4,898,754)
2,010,867	**439,953**	**4,391,114**	**5,231,506**
504,107	(148,352)	(836,429)	8,030,672
6,726,590	**7,966,228** *	**12,093,335** *	**4,218,304** *
$ 7,230,697	**$ 7,817,876**	**$ 11,256,906**	**$ 12,248,976**

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		**$ 8,030,672**
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	(360,351)	
Disposal of assets	(2,159,283)	
Purchase of assets	6,406,086	
		3,886,452
• Some revenues in the Statement of Activities do not provide current financial resources, and therefore, are unavailable in governmental funds. Revenues related to prior periods that became available during the current period are reported in the governmental funds. This amount is the net adjustment.		65,143
• 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.		(252,219)
• 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 Position. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Position. The following amounts represent the difference between proceeds and repayments:		
General obligation bonds	(1,001,934)	
Revenue bonds	237,312	
Certificates of participation and commercial paper	(492,315)	
		(1,256,937)
• 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	(294,632)	
Capital leases	(383,286)	
Net other postemployment benefits obligation	(3,010,788)	
Mandated costs	(362,729)	
Workers' compensation	(237,549)	
Loans payable	2,032,275	
Proposition 98 funding guarantee	333,612	
Net pension obligation	(97,172)	
Pollution remediation obligations	33,831	
Other noncurrent liabilities	24,365	
		(1,962,073)
Change in net position of governmental activities		**$ 8,511,038**

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

Statement of Net Position

Proprietary Funds

June 30, 2013

(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 544,738
Amount on deposit with U.S. Treasury	—	—
Investments	—	—
Restricted assets:		
Cash and pooled investments	764,000	—
Due from other governments	—	—
Net investment in direct financing leases	—	—
Receivables (net)	—	92,373
Due from other funds	4,000	899
Due from other governments	—	20,227
Prepaid items	—	—
Inventories	—	7,413
Recoverable power costs (net)	111,000	—
Other current assets	14,000	—
Total current assets	893,000	665,650
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	637,000	76,825
Investments	300,000	74,001
Loans receivable	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	—	—
Interfund receivables	—	91,517
Loans receivable	—	16,468
Recoverable power costs (net)	5,083,000	—
Long-term prepaid charges	—	897,370
Capital assets:		
Land	—	136,797
Collections – nondepreciable	—	—
Buildings and other depreciable property	—	4,880,380
Intangible assets – amortizable	—	36,768
Less: accumulated depreciation/amortization	—	(2,366,429)
Construction in progress	—	498,350
Intangible assets – nonamortizable	—	142,099
Other noncurrent assets	—	—
Total noncurrent assets	6,020,000	4,484,146
Total assets	**6,913,000**	**5,149,796**
DEFERRED OUTFLOWS OF RESOURCES	**106,000**	**124,591**
Total assets and deferred outflows of resources	**$ 7,019,000**	**$ 5,274,387**

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

Business-type Activities – Enterprise Funds						**Governmental Activities**
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ 342,925	$ 3,135,982	$ 533,042	$ 812,288	$ 5,368,975	$ 941,011
—	—	39,963	—	—	39,963	—
—	133,867	—	2,101,965	—	2,235,832	—
2,400,778	—	—	—	34,571	3,199,349	—
—	—	—	—	20,448	20,448	—
443,707	—	—	10,992	19,306	474,005	—
197,801	362,744	1,275,655	161,990	46,115	2,136,678	45,665
30,134	277	22,416	436	2,332	60,494	310,889
—	—	137,425	—	204,361	362,013	7,964
—	5,768	5,223	39,945	1	50,937	109,692
—	7,863	—	—	2,699	17,975	84,910
—	—	—	—	—	111,000	—
—	—	—	—	—	14,000	—
3,072,420	853,444	4,616,664	2,848,370	1,142,121	14,091,669	1,500,131
328,122	—	—	39	—	1,041,986	—
21,738	—	—	—	10,662	406,401	—
—	—	—	—	325,930	325,930	—
—	828,347	—	417,729	22,701	1,268,777	—
7,148,043	—	—	371,361	—	7,519,404	—
—	—	30,476	272,644	—	303,120	—
—	—	611,690	—	5,600	708,807	16,975
—	—	—	87,171	3,661,635	3,765,274	—
—	—	—	—	—	5,083,000	—
10,912	19,413	—	—	2,371	930,066	—
—	6,469	—	72,350	1,272	216,888	2,312
—	—	—	6,051	—	6,051	—
—	142,820	17,726	6,205,510	17,975	11,264,411	633,822
—	—	12,279	123,648	1,350	174,045	59,065
—	(67,038)	(9,052)	(2,233,612)	(16,928)	(4,693,059)	(528,772)
1,701,212	—	—	387,569	—	2,587,131	1,233
—	—	255,008	6,691	181	403,979	29,358
—	—	—	17,329	15,501	32,830	—
9,210,027	930,011	918,127	5,734,480	4,048,250	31,345,041	213,993
12,282,447	**1,783,455**	**5,534,791**	**8,582,850**	**5,190,371**	**45,436,710**	**1,714,124**
213,937	—	—	**32,020**	**3,760**	**480,308**	—
$ 12,496,384	**$ 1,783,455**	**$ 5,534,791**	**$ 8,614,870**	**$ 5,194,131**	**$ 45,917,018**	**$ 1,714,124**

(continued)

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

Statement of Net Position (continued)

Proprietary Funds

June 30, 2013
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 9,000	$ 106,490
Due to other funds	—	49,172
Due to component units	—	—
Due to other governments	—	98,753
Revenues received in advance	—	—
Deposits	—	—
Contracts and notes payable	—	—
Interest payable	52,000	13,741
Benefits payable	—	—
Current portion of long-term obligations	702,000	192,872
Other current liabilities	2,000	—
Total current liabilities	765,000	461,028
Noncurrent liabilities:		
Interfund payables	—	—
Loans payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	487	33,305
Certificates of participation, commercial paper, and other borrowings	—	50,505
Capital lease obligations	—	—
General obligation bonds payable	—	241,835
Revenue bonds payable	6,249,000	2,479,684
Net other postemployment benefits obligation	4,513	140,470
Pollution remediation obligations	—	15,107
Revenues received in advance	—	—
Other noncurrent liabilities	—	175,589
Total noncurrent liabilities	6,254,000	3,136,495
Total liabilities	**7,019,000**	**3,597,523**
DEFERRED INFLOWS OF RESOURCES	—	471,436
Total liabilities and deferred inflows of resources	**$ 7,019,000**	**$ 4,068,959**

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

Business-type Activities – Enterprise Funds						Governmental Activities
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 200,200	$ 60,505	$ 7,200	$ 169,394	$ 4,120	$ 556,909	$ 264,732
19,421	375,155	35,056	—	2,934	481,738	107,471
—	—	—	—	—	—	2
11,782	—	50,313	—	60	160,908	1,280
5,790	3,141	39,060	244,712	42	292,745	331,582
—	—	—	—	—	—	761
—	—	—	—	—	—	10,715
122,314	—	—	—	12,712	200,767	—
—	—	763,914	—	—	763,914	—
534,853	491,123	—	284,978	38,211	2,244,037	17,985
—	—	44,718	349,569	16	396,303	9,113
894,360	929,924	940,261	1,048,653	58,095	5,097,321	743,641
—	—	—	—	—	—	139,282
—	—	8,585,318	—	—	8,585,318	—
—	707,781	—	—	—	707,781	—
—	7,816	55,296	89,528	2,776	189,208	162,900
—	—	—	26,715	—	77,220	—
—	—	—	847,352	—	847,352	—
—	—	—	—	584,033	825,868	—
11,221,620	—	—	3,649,307	479,415	24,079,026	—
—	33,788	105,661	219,018	6,779	510,229	365,286
—	—	—	—	—	15,107	—
—	—	—	11,439	—	11,439	—
—	2,078	—	180,234	75,360	433,261	50,751
11,221,620	751,463	8,746,275	5,023,593	1,148,363	36,281,809	718,219
12,115,980	**1,681,387**	**9,686,536**	**6,072,246**	**1,206,458**	**41,379,130**	**1,461,860**
—	—	—	—	—	471,436	—
$ 12,115,980	**$ 1,681,387**	**$ 9,686,536**	**$ 6,072,246**	**$ 1,206,458**	**$ 41,850,566**	**$ 1,461,860**

(continued)

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

Statement of Net Position (continued)

Proprietary Funds

June 30, 2013

(amounts in thousands)

	Electric Power	Water Resources
NET POSITION		
Investment in capital assets	$ —	$ 785,460
Restricted:		
Nonexpendable – endowments	—	—
Expendable:		
Construction	—	419,968
Debt service	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment programs	—	—
Other purposes	—	—
Total expendable	—	419,968
Unrestricted	—	—
Total net position (deficit)	**—**	**1,205,428**
Total liabilities, deferred inflows of resources, and net position	**$ 7,019,000**	**$ 5,274,387**

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

Business-type Activities – Enterprise Funds						Governmental Activities
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ 82,252	$ 275,960	$ 572,160	$ 2,816	$ 1,718,648	$ 127,459
—	—	—	20,627	—	20,627	—
373,608	—	—	20,567	—	814,143	—
6,796	—	—	3,819	190,146	200,761	—
—	—	—	—	346,377	346,377	—
—	102,068	—	—	—	102,068	—
—	—	3,433,769	—	—	3,433,769	—
—	—	—	44,134	210,662	254,796	—
380,404	102,068	3,433,769	68,520	747,185	5,151,914	—
—	(82,252)	(7,861,474)	1,881,317	3,237,672	(2,824,737)	124,805
380,404	**102,068**	**(4,151,745)**	**2,542,624**	**3,987,673**	**4,066,452**	**252,264**
$ 12,496,384	**$ 1,783,455**	**$ 5,534,791**	**$ 8,614,870**	**$ 5,194,131**	**$ 45,917,018**	**$ 1,714,124**

(concluded)

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

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

Proprietary Funds

Year Ended June 30, 2013

(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	(402,000)	146,277
Student tuition and fees	—	—
Services and sales	—	980,918
Investment and interest	—	—
Rent	—	—
Grants and contracts	—	—
Other	—	—
Total operating revenues	**(402,000)**	**1,127,195**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	(426,000)	258,899
Personal services	—	273,393
Supplies	—	—
Services and charges	18,000	290,345
Depreciation	—	85,236
Scholarships and fellowships	—	—
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization (recovery) of long-term prepaid charges	—	—
Other	—	—
Total operating expenses	**(408,000)**	**907,873**
Operating income (loss)	6,000	219,322
NONOPERATING REVENUES (EXPENSES)		
Donations and grants	—	—
Private gifts	—	—
Investment and interest income	890,000	—
Interest expense and fiscal charges	(896,000)	(53,492)
Lottery payments for education	—	—
Other	—	(165,830)
Total nonoperating revenues (expenses)	**(6,000)**	**(219,322)**
Income (loss) before capital contributions and transfers	—	—
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net position	—	—
Total net position (deficit) – beginning	**—**	**1,205,428**
Total net position (deficit) – ending	**$ —**	**$ 1,205,428**

* Restated

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

Business-type Activities – Enterprise Funds						**Governmental Activities**
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 18,590,498	$ —	$ —	$ 18,590,498	$ —
—	4,445,873	—	—	—	4,445,873	—
—	—	—	—	—	(255,723)	—
—	—	—	2,081,251	—	2,081,251	—
—	—	—	437,981	92,695	1,511,594	2,327,546
1,628	—	—	—	108,593	110,221	—
468,618	—	—	—	7,241	475,859	—
—	—	—	91,361	—	91,361	—
145,795	—	—	187,155	2,139	335,089	—
616,041	**4,445,873**	**18,590,498**	**2,797,748**	**210,668**	**27,386,023**	**2,327,546**
—	2,652,095	—	—	—	2,652,095	—
—	—	—	—	—	(167,101)	—
—	56,781	188,418	3,837,959	13,980	4,370,531	863,255
—	13,581	63	1,089,908	—	1,103,552	10,411
13,479	456,647	85,773	—	63,847	928,091	1,599,644
—	5,980	1,636	249,917	551	343,320	49,162
—	—	—	826,933	—	826,933	—
—	—	17,323,329	—	—	17,323,329	—
395,073	—	—	—	54,192	449,265	—
1,852	—	—	—	255	2,107	—
—	—	—	—	871	871	—
410,404	**3,185,084**	**17,599,219**	**6,004,717**	**133,696**	**27,832,993**	**2,522,472**
205,637	1,260,789	991,279	(3,206,969)	76,972	(446,970)	(194,926)
—	—	—	1,323,345	—	1,323,345	—
—	—	—	47,861	—	47,861	—
—	—	7,464	41,522	1,661	940,647	765
—	(52,309)	—	(191,824)	(533)	(1,194,158)	(394)
—	(1,262,058)	—	—	—	(1,262,058)	—
—	48	—	4,301	(4,952)	(166,433)	(897)
—	**(1,314,319)**	**7,464**	**1,225,205**	**(3,824)**	**(310,796)**	**(526)**
205,637	(53,530)	998,743	(1,981,764)	73,148	(757,766)	(195,452)
—	—	—	481	141,823	142,304	—
202	—	—	2,034,055	—	2,034,257	4,730
(8,172)	—	—	(16,540)	(11,786)	(36,498)	(61,497)
197,667	(53,530)	998,743	36,232	203,185	1,382,297	(252,219)
182,737 *	**155,598**	**(5,150,488)**	**2,506,392** *	**3,784,488** *	**2,684,155** *	**504,483**
$ 380,404	**$ 102,068**	**$ (4,151,745)**	**$ 2,542,624**	**$ 3,987,673**	**$ 4,066,452**	**$ 252,264**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2013

(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ (371,000)	$ 1,088,771
Receipts from interfund services provided	—	—
Payments to suppliers	(73,000)	(438,273)
Payments to employees	(6,000)	(273,393)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	21,000	2,709
Net cash provided by (used in) operating activities	**(429,000)**	**379,814**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Receipts of bond charges	869,000	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(574,000)	—
Interest paid on operating debt	(341,000)	—
Transfers in	—	—
Transfers out	—	—
Grants received / (provided)	—	—
Lottery payments for education	—	—
Net cash provided by (used in) noncapital financing activities	**(46,000)**	—
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of capital assets	—	(200,249)
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	121,961
Principal paid on notes payable and commercial paper	—	(100,239)
Proceeds from capital leases	—	—
Payment on capital debt and leases	—	—
Retirement of general obligation bonds	—	(59,455)
Proceeds from revenue bonds	—	899,887
Retirement of revenue bonds	—	(756,280)
Interest paid	—	(160,668)
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	—	**(255,043)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	—	(302,608)
Proceeds from maturity and sale of investments	—	302,608
Change in interfund receivables and loans receivable	—	2,674
Earnings (loss) on investments	11,000	8,468
Net cash provided by (used in) investing activities	**11,000**	**11,142**
Net increase (decrease) in cash and pooled investments	(464,000)	135,913
Cash and pooled investments – beginning	**1,865,000**	**485,650**
Cash and pooled investments – ending	**$ 1,401,000**	**$ 621,563**

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

Business-type Activities – Enterprise Funds						Governmental Activities
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 844,190	$ 4,407,307	$ 18,343,035	$ 2,495,410	$ 367,013	$ 27,174,726	$ 2,487,452
—	—	4,723	—	418	5,141	40,781
(3,894)	(185,080)	(78,639)	(1,089,009)	(67,487)	(1,935,382)	(1,489,656)
—	(43,282)	(157,691)	(3,782,921)	(10,993)	(4,274,280)	(769,523)
—	(18,752)	(9,613)	(1,124)	(519)	(30,008)	(203,270)
—	(2,929,425)	—	—	—	(2,929,425)	—
—	(302,965)	(17,285,755)	—	—	(17,588,720)	—
(256,203)	142,755	53,598	(600,141)	(27,430)	(663,712)	(11,631)
584,093	**1,070,558**	**869,658**	**(2,977,785)**	**261,002**	**(241,660)**	**54,153**
—	—	(691,850)	(422)	5	(692,267)	(612)
—	—	—	—	—	869,000	—
—	—	—	—	(286,894)	(286,894)	—
—	—	—	—	(78,755)	(652,755)	—
—	—	—	—	—	(341,000)	(3)
202	—	—	1,986,671	—	1,986,873	4,730
(8,172)	—	—	—	(15,987)	(24,159)	(61,497)
—	—	—	1,491,288	—	1,491,288	—
—	(1,187,366)	—	—	—	(1,187,366)	—
(7,970)	**(1,187,366)**	**(691,850)**	**3,477,537**	**(381,631)**	**1,162,720**	**(57,382)**
—	—	—	—	189	189	—
(1,370,049)	(3,102)	(52,889)	(416,056)	(692)	(2,043,037)	(60,928)
—	4	—	236	47	287	1,349
—	—	—	19,585	—	141,546	—
—	—	—	—	—	(100,239)	(10,912)
—	—	—	22,601	—	22,601	—
—	—	—	(370,200)	—	(370,200)	—
—	—	—	—	—	(59,455)	—
1,274,119	—	—	564,631	—	2,738,637	—
(554,985)	—	—	(313,843)	—	(1,625,108)	—
—	—	—	—	—	(160,668)	(392)
—	—	—	21,380	216,705	238,085	—
(650,915)	**(3,098)**	**(52,889)**	**(471,666)**	**216,249**	**(1,217,362)**	**(70,883)**
—	(119,590)	—	(12,283,345)	—	(12,705,543)	—
—	275,316	17,101	12,178,674	6,559	12,780,258	—
—	93,928	901,244	121,176	33,400	1,152,422	281,065
—	23,800	7,464	43,148	1,709	95,589	823
—	**273,454**	**925,809**	**59,653**	**41,668**	**1,322,726**	**281,888**
(74,792)	153,548	1,050,728	87,739	137,288	1,026,424	207,776
2,803,692	**189,377**	**2,085,254**	**445,342**	**709,571**	**8,583,886**	**733,235**
$ 2,728,900	**$ 342,925**	**$ 3,135,982**	**$ 533,081**	**$ 846,859**	**$ 9,610,310**	**$ 941,011**

(continued)

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

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2013

(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ 6,000	$ 219,322
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	85,236
Provisions and allowances	—	—
Accretion of capital appreciation bonds	—	—
Amortization of premiums and discounts	—	—
Amortization of long-term prepaid charges	—	9,362
Other	—	2,709
Change in assets and liabilities:		
Receivables	—	18,274
Due from other funds	—	—
Due from other governments	—	(4,440)
Prepaid items	—	—
Inventories	—	22,240
Net investment in direct financing leases	—	—
Recoverable power costs (net)	(421,000)	—
Other current assets	35,000	—
Loans receivable	—	—
Other noncurrent assets	—	—
Accounts payable	(49,000)	55,258
Due to other funds	—	15,148
Due to component units	—	—
Due to other governments	—	(43,295)
Deposits	—	—
Interest payable	—	—
Other current liabilities	—	—
Interfund payables	—	—
Current portion of revenues received in advance	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Long-term portion of revenue received in advance	—	—
Other noncurrent liabilities	—	—
Total adjustments	(435,000)	160,492
Net cash provided by (used in) operating activities	**$ (429,000)**	**$ 379,814**
Noncash investing, capital, and financing activities		
Interest accreted on annuitized prizes	$ —	$ —
Interest accreted on zero coupon bonds	—	—
Unclaimed Lottery prizes directly allocated to Education Fund	—	—
Unrealized gain (loss) on investment	—	—
Amortization of prepaid interest related to capital lease obligations	—	—
Contributed capital assets	—	—
Acquisition of capital assets through capital lease	—	—
Change in accrued capital assets purchases	—	—
Gifts in-kind	—	—
Amortization of loss on debt refundings	—	—
Amortization of bond premium and discount	—	36,885
Principal retirements of long-term debt on proceeds received from issuance of bonds	—	632,125
Other miscellaneous noncash transactions	—	—

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

Business-type Activities – Enterprise Funds						Governmental Activities
Public Buildings Construction	**State Lottery**	**Unemployment Programs**	**California State University**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 205,637	$ 1,260,789	$ 991,279	$ (3,206,969)	$ 76,972	$ (446,970)	$ (194,926)
—	—	—	—	—	—	(114)
—	5,980	1,636	249,917	551	343,320	49,162
—	(11,426)	—	—	—	(11,426)	—
—	—	—	—	3,936	3,936	—
(28,468)	—	—	—	47	(28,421)	—
22,679	—	—	—	4,359	36,400	—
1,523	99	—	—	(6,874)	(2,543)	—
—	(48,165)	23,262	(58,027)	1,699	(62,957)	88,163
(23,295)	—	14,469	(1,124)	5,865	(4,085)	(124,743)
—	—	81,942	—	1,036	78,538	1,120
—	(18,356)	—	(68,303)	11	(86,648)	(6,909)
—	84	—	—	593	22,917	6,454
399,823	—	—	—	19,342	419,165	—
—	—	—	—	—	(421,000)	—
—	—	180	—	4,201	39,381	43
—	—	—	—	184,463	184,463	—
—	(3,553)	—	—	—	(3,553)	—
175	17,699	7,197	11,654	(2,070)	40,913	108,193
(361)	(5,671)	6,350	—	(2,453)	13,013	(23,771)
—	—	—	—	—	—	(1,032)
(323)	—	1,501	—	(302)	(42,419)	1,218
—	—	—	762	(71)	691	(6,922)
6,690	—	—	—	(100)	6,590	296
—	580	(55,734)	59,198	(7,574)	(3,530)	5,566
—	—	—	—	—	—	(29)
13	311	(270,725)	—	(9)	(270,410)	58,584
—	—	37,574	5,505	82	43,161	36,187
—	(134,695)	—	—	—	(134,695)	—
—	—	9,354	1,217	100	10,671	17,543
—	—	—	(16,202)	(212)	(16,414)	—
—	6,882	21,373	44,587	(22,590)	50,252	40,070
378,456	(190,231)	(121,621)	229,184	184,030	205,310	249,079
$ 584,093	**$ 1,070,558**	**$ 869,658**	**$ (2,977,785)**	**$ 261,002**	**$ (241,660)**	**$ 54,153**
						(concluded)
$ —	$ 49,777	$ —	$ —	$ —	$ 49,777	$ —
—	16,035	—	—	—	16,035	—
—	22,313	—	—	—	22,313	—
—	(42,158)	—	—	—	(42,158)	—
—	—	—	2,795	—	2,795	—
—	—	—	19,015	—	19,015	—
—	—	—	1,390	—	1,390	—
—	—	—	(5,889)	—	(5,889)	—
—	—	—	502	—	502	—
—	—	—	10,594	—	10,594	—
—	—	—	(8,199)	—	28,686	—
—	—	—	—	—	632,125	—
—	—	—	5,259	—	5,259	15,144

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

Statement of Fiduciary Net Position

Fiduciary Funds and Similar Component Units

June 30, 2013
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 99,345	$ 4,640,690	$ 21,193,406	$ 3,968,545
Investments, at fair value:				
Short-term	—	8,741,312	—	—
Equity securities	2,600,359	227,650,389	—	—
Debt securities	1,591,782	84,719,163	—	—
Real estate	165,882	51,196,862	—	—
Other	698,174	66,268,645	—	—
Securities lending collateral	—	40,497,424	—	—
Total investments	5,056,197	479,073,795	—	—
Receivables (net)	6,014	5,127,682	32,164	1,477,731
Due from other funds	2	482,303	—	18,271,064
Due from other governments	—	18,018	—	21,048
Prepaid items	—	—	—	12,033
Interfund receivables	—	—	—	—
Loans receivable	—	23,042	—	7,153
Other assets	210,418	949,551	—	87
Total assets	**5,371,976**	**490,315,081**	**21,225,570**	**23,757,661**
DEFERRED OUTFLOWS OF RESOURCES	—	—	—	—
Total assets and deferred outflows of resources	**5,371,976**	**490,315,081**	**21,225,570**	**$ 23,757,661**
LIABILITIES				
Accounts payable	6,372	2,597,584	382	$ 10,084,927
Due to other governments	—	79	13,088	11,702,335
Tax overpayments	—	—	—	684
Benefits payable	—	2,488,929	—	220,767
Revenues received in advance	—	—	—	18,501
Deposits	210,418	—	—	989,518
Securities lending obligations	—	40,272,852	—	—
Loans payable	—	937,494	—	—
Other liabilities	530	837,652	—	740,929
Total liabilities	**217,320**	**47,134,590**	**13,470**	**23,757,661**
DEFERRED INFLOWS OF RESOURCES	—	—	—	—
Total liabilities and deferred inflows of resources	**217,320**	**47,134,590**	**13,470**	**$ 23,757,661**
NET POSITION				
Held in trust for pension benefits, pool participants, and other purposes	**$ 5,154,656**	**$ 443,180,491**	**$ 21,212,100**	

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

Statement of Changes in Fiduciary Net Position

Fiduciary Funds and Similar Component Units

Year Ended June 30, 2013

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 13,025,787	$ —
Plan member	—	7,049,253	—
Total contributions	—	20,075,040	—
Investment income:			
Net appreciation (depreciation) in fair value of investments	288,283	44,767,618	—
Interest, dividends, and other investment income	165,302	10,666,103	64,143
Less: investment expense	(4,519)	(3,039,584)	—
Net investment income	449,066	52,394,137	64,143
Receipts from depositors	2,525,632	—	22,937,870
Other	—	22,988	—
Total additions	**2,974,698**	**72,492,165**	**23,002,013**
DEDUCTIONS			
Distributions paid and payable to participants	—	28,743,752	62,497
Refunds of contributions	—	430,234	—
Administrative expense	1	587,692	1,646
Interest expense	—	187,084	—
Payments to and for depositors	2,485,162	673,609	23,609,233
Total deductions	**2,485,163**	**30,622,371**	**23,673,376**
Change in net position	489,535	41,869,794	(671,363)
Net position – beginning	**4,665,121**	**401,310,697** *	**21,883,463**
Net position – ending	**$ 5,154,656**	**$ 443,180,491**	**$ 21,212,100**

* Restated

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

Discretely Presented Component Units Financial Statements

Statement of Net Position

Discretely Presented Component Units – Enterprise Activity

June 30, 2013

(amounts in thousands)

	University of California	**California Housing Finance Agency**
ASSETS		
Current assets:		
Cash and pooled investments	$ 334,008	$ 1,273,366
Investments	5,294,206	137,625
Restricted assets:		
Cash and pooled investments	—	—
Investments	—	—
Receivables (net)	3,432,089	209,477
Due from primary government	209,112	—
Due from other governments	438,815	—
Prepaid items	—	409
Inventories	185,991	—
Other current assets	235,440	4,100
Total current assets	10,129,661	1,624,977
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	—	—
Investments	—	—
Investments	22,431,417	489,991
Receivables (net)	1,139,619	—
Loans receivable	—	4,631,407
Long-term prepaid charges	—	17,728
Capital assets:		
Land	840,050	—
Collections – nondepreciable	354,109	—
Buildings and other depreciable property	39,381,859	2,104
Intangible assets – amortizable	654,373	—
Less: accumulated depreciation/amortization	(17,948,712)	(1,142)
Construction in progress	2,898,206	—
Intangible assets – nonamortizable	—	—
Other noncurrent assets	268,614	20,556
Total noncurrent assets	50,019,535	5,160,644
Total assets	**60,149,196**	**6,785,621**
DEFERRED OUTFLOWS OF RESOURCES	**45,758**	**126,717**
Total assets and deferred outflows of resources	**$ 60,194,954**	**$ 6,912,338**

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

Nonmajor Component Units	**Total**
$ 460,680	$ 2,068,054
390,114	5,821,945
90,659	90,659
11,636	11,636
302,000	3,943,566
13	209,125
—	438,815
759	1,168
—	185,991
40,018	279,558
1,295,879	13,050,517
34,218	34,218
14,498	14,498
1,588,809	24,510,217
284,662	1,424,281
305,508	4,936,915
—	17,728
130,656	970,706
8,264	362,373
1,959,458	41,343,421
20,169	674,542
(942,463)	(18,892,317)
19,336	2,917,542
5,131	5,131
44,300	333,470
3,472,546	58,652,725
4,768,425	**71,703,242**
5,071	**177,546**
$ 4,773,496	**$ 71,880,788**

(continued)

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

Statement of Net Position (continued)

Discretely Presented Component Units – Enterprise Activity

June 30, 2013
(amounts in thousands)

	University of California	California Housing Finance Agency
LIABILITIES		
Current liabilities:		
Accounts payable	$ 2,231,145	$ 116,555
Due to other governments	—	595
Revenues received in advance	994,580	—
Deposits	509,090	244,112
Contracts and notes payable	—	2,888
Interest payable	—	70,690
Securities lending obligations	1,468,772	—
Benefits payable	—	—
Current portion of long-term obligations	2,072,009	110,346
Other current liabilities	2,748,119	85
Total current liabilities	10,023,715	545,271
Noncurrent liabilities:		
Compensated absences payable	237,331	—
Certificates of participation, commercial paper, and other borrowings	—	—
Capital lease obligations	2,394,586	—
Revenue bonds payable	12,091,416	4,791,094
Net other postemployment benefits obligation	7,577,366	18,685
Pollution remediation obligation	66,523	—
Other noncurrent liabilities	4,876,948	250,587
Total noncurrent liabilities	27,244,170	5,060,366
Total liabilities	**37,267,885**	**5,605,637**
DEFERRED INFLOWS OF RESOURCES	**31,575**	—
Total liabilities and deferred inflows of resources	**37,299,460**	**5,605,637**
NET POSITION		
Investment in capital assets	11,954,384	980
Restricted:		
Nonexpendable – endowments	3,916,721	—
Expendable:		
Endowments and gifts	8,149,631	—
Education	947,426	—
Indenture	—	347,318
Employee benefits	—	—
Workers’ compensation liability	—	—
Statute	—	1,070,365
Other purposes	—	—
Total expendable	9,097,057	1,417,683
Unrestricted	(2,072,668)	(111,962)
Total net position	**22,895,494**	**1,306,701**
Total liabilities, deferred inflows of resources, and net position	**$ 60,194,954**	**$ 6,912,338**

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

Nonmajor Component Units	Total
$ 94,717	$ 2,442,417
—	595
62,631	1,057,211
1,438	754,640
7,494	10,382
1,981	72,671
—	1,468,772
—	—
107,382	2,289,737
124,482	2,872,686
400,125	10,969,111
11,676	249,007
63,170	63,170
349,227	2,743,813
366,734	17,249,244
123,015	7,719,066
—	66,523
365,857	5,493,392
1,279,679	33,584,215
1,679,804	**44,553,326**
2,481	**34,056**
1,682,285	**44,587,382**
522,541	12,477,905
867,289	4,784,010
6,903	8,156,534
776,111	1,723,537
—	347,318
—	—
—	—
278,519	1,348,884
21,814	21,814
1,083,347	11,598,087
618,034	(1,566,596)
3,091,211	**27,293,406**
$ 4,773,496	**$ 71,880,788**

(concluded)

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

Statement of Activities

Discretely Presented Component Units – Enterprise Activity

Year Ended June 30, 2013

(amounts in thousands)

	University of California	California Housing Finance Agency
OPERATING EXPENSES		
Personal services	$ 17,299,665	$ 29,853
Scholarships and fellowships	591,610	—
Supplies	2,465,149	—
Services and charges	281,276	50,472
Department of Energy laboratories	1,026,088	—
Depreciation	1,555,254	284
Distributions to beneficiaries	—	—
Interest expense and fiscal charges	669,538	171,835
Amortization of long-term prepaid charges	—	68,613
Grants provided	286,222	—
Other	3,455,257	111,653
Total operating expenses	**27,630,059**	**432,710**
PROGRAM REVENUES		
Charges for services	15,325,540	39,976
Operating grants and contributions	7,655,258	38,624
Capital grants and contributions	256,670	—
Total program revenues	**23,237,468**	**78,600**
Net revenues (expenses)	(4,392,591)	(354,110)
GENERAL REVENUES		
Investment and interest income (loss)	1,687,977	264,168
Other	2,355,795	39,275
Total general revenues	**4,043,772**	**303,443**
Change in net position	(348,819)	(50,667)
Net position – beginning	**23,244,313** *	**1,357,368**
Net position – ending	**$ 22,895,494**	**$ 1,306,701**

* Restated

Nonmajor Component Units	Total
$ 463,575	$ 17,793,093
51,153	642,763
9,326	2,474,475
1,241,747	1,573,495
—	1,026,088
69,848	1,625,386
—	—
38,253	879,626
—	68,613
—	286,222
65,017	3,631,927
1,938,919	**30,001,688**
1,022,680	16,388,196
546,344	8,240,226
17,350	274,020
1,586,374	**24,902,442**
(352,545)	(5,099,246)
163,335	2,115,480
411,249	2,806,319
574,584	**4,921,799**
222,039	(177,447)
2,869,172 *	**27,470,853** *
$ 3,091,211	**$ 27,293,406**

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2013:

GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements; improves financial reporting by addressing issues relating to service concession arrangements which are a type of public-private or public-public partnership;*

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34; modifies certain requirements for inclusion of component units (legally separate organizations) in the financial reporting entity;*

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) Pronouncements*; *improves financial reporting by contributing to GASB's efforts to codify all sources of GAAP for state and local governments so that they derive from a single source;*

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*; *provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and their effect on government's net position; and*

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities; establishes accounting and financial reporting standards that reclassify as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.*

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. 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 legally separate fiduciary component units that administer pension and other employee benefit trust funds. The State appoints a voting majority of the board members of both plans which, due to their fiduciary nature, 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 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 plan. CalPERS administers the following seven pension and other employee benefits 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 Plan, 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. The State is financially accountable for CalSTRS. CalSTRS administers four pension and other employee benefit trust funds, the Defined Benefit Program, the Defined Benefit Supplement Program, the Cash Balance Benefit Program, and the Replacement Benefit Program. 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 California Housing Finance Agency, and nonmajor component units.

The *University of California* was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California (Regents). The University of California is a component unit of the State because the State appoints a voting majority of the Regents and provides financial assistance to the University. 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, 1111 Franklin Street, Oakland, California 94607-5200.

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 appoints the executive director who administers the day-to-day operations. Copies of CalHFA's financial statements may be obtained from the California Housing Finance Agency, P.O. Box 4034, Sacramento, California 95812.

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. 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, and the primary government can impose its will on the entity or the entity provides a specific financial benefit to or imposes a financial burden on 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;

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, 2012);

The Public Employees' Contingency Reserve, which provides health benefit plans for state employees and annuitants;

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 *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.

The following entities were previously reported as Component Units but have been reclassified as Related Organization due to changes in their reporting requirements pursuant to implementation of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34:*

1. State Compensation Insurance Fund
2. California Pollution Control Financing Authority
3. California Health Facilities Financing Authority
4. California School Finance Authority
5. California Educational Facilities Authority

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. 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, 2013, CADA had total assets of $33 million, total liabilities of $20 million, and total net position of $13 million. Total revenues for the fiscal year were $10 million and expenses were $11 million, resulting in a decrease in net position of $400 thousand. Because the primary government does not have 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 *State Compensation Insurance Fund* (*State Fund*) was established by the State of California through legislation enacted in 1913 to provide an available market for workers' compensation insurance to employees located in California. State Fund operates in competition with other insurance carriers to serve California businesses. The State appoints all eleven members of the State Fund's governing board. 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 State Fund, the financial information of this institution is not included in the financial statement of this report. For information regarding obtaining copies of the financial statements of the State Fund, contact State Compensation Insurance Fund, 333 Bush Street, 8th Floor, San Francisco, California 94104.

The *California Health Benefit Exchange (the Exchange),* an independent public entity, offers new health insurance to individuals, families, and small businesses. A five-member board of state-elected officials governs the Exchange. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the Exchange, 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 Exchange, contact Covered California, P.O. Box 989725, West Sacramento, California 95798-9725.

The *California Pollution Control Financing Authority (CPCFA)* was created through the California Pollution Control Financing Authority Act of 1972. The CPCFA is a legally separate entity that provides financing for pollution control facilities. A three-member board of state-elected officials governs the CPCFA. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CPCFA, 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 CPCFA, contact the State Treasurer's Office, 915 Capitol Mall, Room 457, Sacramento, California 95814.

The *California Health Facilities Financing Authority (CHFFA)* was established by the State of California through legislation enacted in 1979. The CHFFA is a legally separate entity that provides financing for the construction, equipping, and acquisition of health facilities. A nine-member board of state-elected officials and appointees govern the CHFFA. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CHFFA, 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 CHFFA, contact the State Treasurer's Office, 915 Capitol Mall, Suite 590, Sacramento, California 95814.

The *California Educational Facilities Authority (CEFA)* was created by the Board of Control Approval in 1974. The CEFA is a legally separate entity established to issue revenue bonds to finance loans for students attending public and private colleges and universities, and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities. A five-member board of state-elected officials and appointees govern the CEFA. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CEFA, 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 for the CEFA, contact the State Treasurer's Office, 915 Capitol Mall, Suite 590, Sacramento, California 95814.

The *California School Finance Authority (CSFA)* was created in 1985. The CSFA is a legally separate entity that provides loans to school and community college districts to assist them in obtaining equipment and facilities. A three-member board of state officials governs the CSFA. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CSFA, the financial information for this institution is not included in the financial statements of this report. For information regarding obtaining copies of the financial statements of the CSFA, contact the State Treasurer's Office, 304 South Broadway, Suite 550, Los Angeles, California 90013.

B. Government-wide and Fund Financial Statements

Government-wide financial statements (the Statement of Net Position 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 Position reports all of the financial and capital resources of the government as a whole in a format in which assets and deferred outflows of resources equal liabilities and deferred inflows of resources, plus net position. 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 activities primarily supported by taxes, grants, and similar revenue sources.

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 position, 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. The State adopted the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* during the year ending June 30, 2013.

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 Buildings Construction Fund* accounts for rental charges from the lease of public assets.

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

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

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.

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 position 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 California Housing Finance Agency, 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 Position. 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 California State University Trust 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. Long-term Prepaid Charges

The long-term prepaid charges account in the enterprise funds primarily represents operating and maintenance 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 long-term prepaid charges. These charges are recognized when billed in the future years under the terms of water supply contracts. The long-term prepaid charges for the Public Buildings Construction Fund include prepaid insurance costs. Long-term prepaid charges are also included in the State Lottery Fund and nonmajor enterprise funds. These prepaid costs are incurred in connection with certain contracts that extend beyond a one-year period, which are amortized as expenses over the remaining life of the contracts.

Bond issuance costs were previously reported as deferred charges. Per GASB 65, these costs should be expensed as incurred, excluding the insurance costs. For fiscal year 2012-13, bond issuance costs are expensed in the State of California's financial statements.

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, 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 Position.

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 Position.

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 and discounts 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 and discount. 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 and discount.

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 Position and Fund Balance

The difference between fund assets, deferred outflows of resources, liabilities, and deferred inflows of resources is called "net position" 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 position:

Net investment in capital assets, 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 position results from transactions with purpose restrictions and is designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net* position is subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net* position is subject to externally imposed restrictions that can be fulfilled by actions of the State. As of June 30, 2013, the government-wide financial statements show restricted net position for the primary government of $29.5 billion, of which $6.7 billion is due to enabling legislation.

Unrestricted net position is neither restricted nor invested in capital assets.

In the fund financial statements, proprietary funds include categories of net position 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 balances include 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.

The *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 position is amounts held in trust for benefits and other purposes.

L. Restatement of Beginning Fund Balances and Net Position

Schedule of Restatement of Beginning Fund Balances and Net Position

(amounts in thousands)

Fund Financial Statements

Governmental Funds		
Major Governmental Funds		
General Fund		
Fund balances as of June 30, 2012, as previously reported	$	(22,961,288)
Overstatement of 2011-12 General Fund expenditures		232,120
Fund balances as of July 1, 2012, as restated	**$**	**(22,729,168)**
Environmental and Natural Resources		
Fund balances as of June 30, 2012, as previously reported	$	7,965,054
GASB 61 adjustments		1,174
Fund balances as of July 1, 2012, as restated	**$**	**7,966,228**
Nonmajor Governmental Funds		
Fund balances as of June 30, 2012, as previously reported	$	11,943,613
Deferred payroll adjustment		11
Reclass from agency fund to special revenue fund		149,711
Fund balances as of July 1, 2012, as restated	**$**	**12,093,335**
Enterprise Funds		
Major Enterprise Funds		
California State University		
Net position as of June 30, 2012, as previously reported	$	2,564,751
GASB 61 adjustments		(58,359)
Net position as of July 1, 2012, as restated	**$**	**2,506,392**
Public Buildings Construction Fund		
Net position as of June 30, 2012, as previously reported	$	239,458
GASB 65 adjustments		(56,721)
Net position as of July 1, 2012, as restated	**$**	**182,737**
Nonmajor Enterprise Funds		
Net position as of June 30, 2012, as previously reported	$	3,792,279
GASB 65 adjustments		(7,791)
Net position as of July 1, 2012, as restated	**$**	**3,784,488**

Fund Financial Statements (continued)

Fiduciary Funds		
Pension and other Employee Benefit Trust		
Net position as of June 30, 2012, as previously reported	$	401,333,900
CalPERS Defined Contribution Pension Plan adjustments		(23,203)
Net position as of July 1, 2012, as restated	**$**	**401,310,697**

Discretely Presented Component Units		
Major Component Units		
University of California		
Net position as of June 30, 2012, as previously reported	$	23,404,025
Change in accounting policy		(159,712)
Net position as of July 1, 2012, as restated	**$**	**23,244,313**

Nonmajor Component Units		
Net position as of June 30, 2012, as previously reported	$	2,915,162
GASB 45 adjustments		(362)
GASB 61 adjustments		(39,366)
GASB 65 adjustments		(6,540)
Other adjustments		278
Net position as of July 1, 2012, as restated	**$**	**2,869,172**

Eliminated Major Component Units		
State Compensation Insurance		
Net position as of June 30, 2012, as previously reported	$	7,083,903
GASB 61 adjustments		(7,083,903)
Net position as of July 1, 2012, as restated	**$**	**—**

Public Employees' Benefits		
Net position as of June 30, 2012, as previously reported	$	301,826
GASB 61 adjustments		(301,826)
Net position as of July 1, 2012, as restated	**$**	**—**

Schedule of Restatement of Beginning Fund Balances and Net Position (continued)

(amounts in thousands)

Government-wide Financial Statements

Governmental Activities

Net position as of June 30, 2012, as previously reported	$	(18,257,716)
GASB 61 adjustments		(6,044)
GASB 65 adjustments		(194,668)
General Fund balance adjustment		232,120
Nonmajor Governmental Fund balance adjustment		149,722
Overstatement of 2011-12 capital leases		240,140
Various capital assets adjustments		1,293,866
Increase in pollution remediation obligation		(105,417)
Other adjustments		(1)
Net position as of July 1, 2012, as restated	**$**	**(16,647,998)**

Business-type Activities

Net position as of June 30, 2012, as previously reported	$	2,807,029
GASB 61 adjustments		(58,359)
GASB 65 adjustments		(64,512)
Other adjustments		(3)
Net position as of July 1, 2012, as restated	**$**	**2,684,155**

Component Units

Net position as of June 30, 2012, as previously reported	$	35,062,284
GASB 45 adjustments		(362)
GASB 61 adjustments		(7,425,095)
GASB 65 adjustments		(6,540)
Adjustments due to change in accounting policy		(159,712)
Other adjustments		278
Net position as of July 1, 2012, as restated	**$**	**27,470,853**

M. Guaranty Deposits

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

N. Deferred Outflows and Deferred Inflows of Resources

The government-wide and fund-based financial statements report deferred outflows of resources and deferred inflows of resources.

Deferred outflows of resources are consumption of assets by the primary government and its component units that are applicable to future reporting periods. Deferred outflows of resources are presented separately after "Total Assets" in the State's financial statements.

Deferred inflows of resources are acquisition of assets by the primary government and its component units that are applicable to future reporting periods. Deferred inflows of resources are presented separately after "Total Liabilities" in the State's financial statements.

Additional information on the State's deferred outflows of resources and deferred inflows of resources can be found in Note 21: *Deferred Outflows of Resources and Deferred Inflows of Resources Including Service Concession Arrangements*.

O. Abnormal Fund Balances

In fiscal year 2012-13, Water Resources Electric Power fund had a net refund of $405 million for power charges revenue. The refund resulted from lower power sales, return of prior year over-collection, and return of reserves, as lower levels of reserve were required. During the fiscal year 2012-13, the fund returned $449 million through adjustments to power charges and separate monthly payments to ratepayers.

P. Nonmajor Enterprise Segment Information

Two nonmajor enterprise fund segments are displayed discretely in the Combining Statement of Net Position; the Combining Statement of Revenues, Expenses, and Changes in Fund Net Position; and the Statement of Cash Flows in the Nonmajor Enterprise Funds. 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 deferred outflows of resources, and liabilities and deferred inflows of resources. All of the activities reported for the fund segments listed below meet these requirements.

> *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.

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, 2013, were legally made, and they had the effect of decreased spending authority for the Budgetary/Legal Basis reported General Fund and Transportation Funds, and increased spending authority for the Environmental and Natural Resources 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 Position. 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, 2013, the discretely presented component units accounted for approximately 2.8% 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, 2013, 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, 2013, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling $28 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. As of June 30, 2013, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 284 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, 2013, 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 2012-13 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, 2013, structured notes and medium-term, asset-backed securities comprised approximately 1.88% 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 0.08% 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

Authorized Investment Type	Maximum Maturity[1]	Maximum Percentage of Portfolio [1]	Maximum Investment in One Issuer [1]	Credit Rating
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 [2]
Corporate bonds/notes	5 years	N/A	N/A	A-/A3/A- [3]
Repurchase agreements	1 year	N/A	N/A	N/A
Reverse repurchase agreements	1 year	10%	N/A	N/A

[1] Limitations are pursuant to the State Treasurer's Office Investment Policy for the Pooled Money Investment Account.

[2] 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.

[3] 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 Treasure'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, 2013
(amounts in thousands)

	Interest Rates [1]	Maturity	Fair Value at Year End	Weighted Average Maturity (in years)
Pooled investments				
U.S. Treasury bills and notes	0.10 - 1.35	53 days - 3.34 years	$ 35,901,748	1.03
U.S. agency bonds and discount notes	0.09 - 0.45	61 days - 2.71 years	3,474,691	0.66
Supranational debentures and discount notes (IBRD)	0.14 - 0.51	149 days - 169 days	450,283	0.46
Small Business Administration loans	0.25 - 1.38	0.25 years	510,254	0.25 [2]
Mortgage-backed securities [3]	5.23 - 6.00	1.59 years - 2.92 years	208,754	2.33
Certificates of deposit	0.09 - 0.46	1 day - 1.25 years	9,266,791	0.16
Commercial paper	0.05 - 0.23	1 day - 155 days	4,254,013	0.07
Total pooled investments			**54,066,534** [4]	
Other primary government investments				
U.S. Treasuries and agencies			2,118,611	2.42
Commercial paper			273,325	0.69
Guaranteed investment contracts			207,850	8.72
Corporate debt securities			837,379	2.23
Repurchase agreements			21,887 [5]	0.00
Other			1,097,011	3.55
Total other primary government investments			**4,556,063**	
Funds outside primary government included in pooled investments				
Less: investment trust funds			21,193,406	
Less: other trust and agency funds			2,037,587	
Less: discretely presented component units			1,649,993	
Total primary government investments			**$ 33,741,611**	

[1] These numbers represent high and low interest rates for each investment type.

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

[3] These securities are issued by U.S. government agencies such as the Federal National Mortgage Association.

[4] 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 $287 million of internal loans to state funds.

[5] These repurchase agreements of the California State University mature in one day.

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, 2013
(amounts in thousands)

	Fair Value at Year End	Percent of Total Pooled Investments
Pooled investments		
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations	$ 208,754	0.39 %

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, 2013
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
Pooled investments [1]		
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 9,347,697
A-1/P-1/F-1	AA/Aa/AA	7,798,080
A-2/P-2/F-2	A/A/A	300,000
Not rated		208,754
Not applicable		36,412,003
Total pooled investments		**$ 54,066,534** [2]
Other primary government investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 1,114,284
A-1/P-1/F-1	AA/Aa/AA	1,267,919
A-2/P-2/F-2	A/A/A	1,104,617
A-3/P-3/F-3	BBB/Baa/BBB	—
B/NP/B	BB/Ba/BB	—
Not rated		525,009
Not applicable		544,234
Total other primary government investments		**$ 4,556,063**

[1] 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.

[2] 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, and $287 million in loans to state funds 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, 2013
(amounts in thousands)

Issuer	Investment Type		Reported Amount	Percent of Total Pooled/Agency Investments	
California State University					
Federal National Mortgage Association	U.S. agency securities	$	218,223	8.66	%
Federal Home Loan Mortgage Corporation	U.S. agency securities		199,935	7.93	
Federal Home Loans Bank Office of Finance	U.S. agency securities		192,634	7.65	
Federal Farm Credit Banks Consolidated Systemwide Bonds	U.S. agency securities		159,879	6.35	
California State Lottery					
State of California	Municipal securities	$	205,304	21.34	%
Commonwealth of Massachusetts	Municipal securities		66,312	6.89	
Golden State Tobacco Securitization Corporation					
Federal Home Loan Mortgage Corporation	U.S. agency securities	$	127,004	25.42	%
Standard Chartered Bank	Commercial paper		125,002	25.02	
Caisse Des Depots ET	Commercial paper		124,007	24.82	
Department of Water Resources Electric Power Fund					
Federal Home Loan Mortgage Corporation	U.S. agency securities	$	100,000	33.33	%
Assured Guaranty Municipal Corporation	Guaranteed investment contracts		100,000	33.33	
Royal Bank of Canada	Guaranteed investment contracts		100,000	33.33	
State Water Resources Development System					
Federal National Mortgage Association	U.S. agency securities	$	74,001	100.00	%

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, 2013, one guaranteed investment contract of the Electric Power Fund in the amount of $100 million was 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 fair value or cost, or amortized cost that approximates fair 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 estimated by third-party advisors or operating partners based upon general market and property specific assumptions that are reviewed and approved by CalSTRS management. Short-term investments are reported at fair value or at cost or amortized cost, which approximates fair value. Fair value for commingled funds is based on information provided by the applicable general partner. Private equity partnerships are valued using their respective Net Asset Value (NAV), calculated in accordance with the general partners' fair valuation policy as of the measurement date, 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 CalPERS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. For CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic securities and international equity securities loaned, respectively. For non-U.S. debt securities loaned, CalSTRS requires 102% of the fair value of the loaned securities. 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 by CalPERS can be recalled on demand by CalPERS, and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the cash collateral at June 30, 2013, had an aggregate weighted average maturity (to final maturity) of 400 days and duration of 10 days. State Street Bank & Trust and eSecLending, LLC had weighted average maturity (to final maturity) of 33 and 205 days, respectively.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2013, had a 28-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 the agents 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, 2013
(amounts in thousands)

Investment Type	**Fair Value**
Equity securities	$ 230,250,748
Debt securities*	95,052,257
Mutual funds	292,393
Real estate	51,362,744
Inflation assets	10,338,702
Insurance contracts	698,174
Private equity	54,612,006
Securities lending collateral	40,497,424
Other	1,025,544
Total investments	**$ 484,129,992**

* 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. 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 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.

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, 2013
(amounts in thousands)

	Fair Value at Year End	Effective Duration (in years) [1]
California Public Employees' Retirement Fund [2]		
U.S. Treasuries and agencies	$ 24,270,732	9.13
Mortgages	11,788,729	4.75
Corporate	10,816,633	9.73
Asset-backed	6,973,386	8.48
Commercial paper	1,250,974	0.02
Municipal	15,622	8.58
International	6,240,593	9.94
Swaps	(43,972)	1.12
Private placement	2,917	2.61
No effective duration	7,516,464	N/A
Total	**$ 68,832,078**	

[1] Effective duration is described in the paragraph preceding this table.

[2] 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, 2013
(amounts in thousands)

	Fair Value at Year End	Effective Duration (in years) [1]
California State Teachers' Retirement System		
Long-term fixed-income investments		
U.S. Government and agency obligations	$ 8,058,069	4.82
Credit obligations	6,418,989	6.39
Corporate high yield	1,893,429	3.95
Leveraged loans	396,632	0.33
Debt core plus	2,915,137	5.19
Special situations	144,892	0.07
Commercial mortgage-backed securities	581,189	3.10
Mortgage-backed securities	7,371,226	4.58
Total	**$ 27,779,563**	

	0-30 days	31-90 days
Short-term fixed-income investments		
Money market securities	$ 1,159,202	$ 574,005
Credit obligations	199,967	300,187
U.S. Government and agency obligations	250,423	79,995
Securitized obligations	157,737	45,707
Total	**$ 1,767,329**	**$ 999,894**

	0-1 day	2-6 days
Securities lending collateral		
Money markets securities	$ 59,782	$ 3,560,213
Credit obligations	—	175,005
U.S. Government and agency obligations	—	676,250
Securitized obligations	—	—
Total	**$ 59,782**	**$ 4,411,468**

[1] Effective duration is described in the paragraph preceding this table.

91-120 days	121-180 days	181-365 days	366+ days	Fair Value at Year End
$ 25,005	$ 97,399	$ —	$ —	$ 1,855,611
24,970	5,135	33,603	—	563,862
85,706	70,077	547,492	257,098	1,290,791
—	10,867	14,986	—	229,297
$ 135,681	**$ 183,478**	**$ 596,081**	**$ 257,098**	**$ 3,939,561**

7-29 days	30-59 days	60-89 days	90+ days	Fair Value at Year End
$ 4,176,367	$ 2,494,463	$ 1,301,237	$ 520,029	$ 12,112,091
1,574,204	885,496	804,483	76,705	3,515,893
30,000	—	—	360,815	1,067,065
4,967,932	243,457	194,713	195,409	5,601,511
$ 10,748,503	**$ 3,623,416**	**$ 2,300,433**	**$ 1,152,958**	**$ 22,296,560**

2. Credit Risk

The CalPERS investment policies require that 89% 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. For CalSTRS, the ratings used to determine the quality of the individual securities are the ratings with the highest degree of risk. Furthermore, the total position of the outstanding debt of any one private or commercial 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 for CalSTRS 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, 2013
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 14,017,812
A-1/P-1/F-1	AA/Aa/AA	20,642,907
A-2/P-2/F-2	A/A/A	7,766,254
A-3/P-3/F-3	BBB/Baa/BBB	11,148,720
B/NP/B	BB/Ba/BB	2,003,767
B/NP/B	B/B/B	1,803,704
C/NP/C	CCC/Caa/CCC	797,422
C/NP/C	CC/Ca/CC	51,975
C/NP/C	C/C/C	7,233
D/NP/D	D/D/D	27,432
Withdrawn		161,777
Not rated		44,896,586
Not applicable		34,282,152
Total fixed-income securities		**$ 137,607,741**

3. Concentration of Credit Risk

The Scholarshare Program Trust Fund held $698 million in insurance contracts of TIAA-CREF Life Insurance Company; this amount represented 14% of the fund's total investments as of June 30, 2013.

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, 2013, were not exposed to custodial risk. As of June 30, 2013, all of CalSTRS' non-cash investments, other than Pension2 investments, are held in CalSTRS' and/or its nominee's name and 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, 2013, CalPERS and CalSTRS held $78.4 billion and $30.4 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 enters into currency forwards and contracts to protect the value of its non-dollar public and private equity assets against a strengthening U.S. dollar, while recognizing opportunities for additional return (alpha) generation 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 (i.e., private equity and real estate) 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, 2013

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

Currency	Cash	Equity	Alternative	Fixed Income
Argentine Peso	$ —	$ —	$ —	$ —
Australian Dollar	29,694	4,890,535	—	175,066
Bermuda Dollar	—	3,292	—	—
Brazilian Real	5,752	1,697,051	—	79,649
British Pound Sterling	85,073	13,435,847	1,031	1,515,787
Canadian Dollar	44,805	5,958,847	185,759	234,298
Cayman Islands Dollar	—	5,084	—	—
Chilean Peso	245	249,108	—	987
Chinese Yuan	—	3,643	—	—
Colombian Peso	20	64,181	—	—
Czech Koruna	189	68,592	—	9,498
Danish Krone	1,251	895,733	—	10,544
Egyptian Pound	11,773	46,706	—	—
Euro	328,321	24,410,720	3,351,690	2,597,692
Guatemalan Quetzal	—	—	—	—
Hong Kong Dollar	27,144	4,391,995	—	—
Hungarian Forint	353	129,148	—	—
Indian Rupee	7,029	1,131,475	—	68
Indonesian Rupiah	1,459	580,827	—	—
Israeli Shekel	1,474	307,458	—	—
Japanese Yen	159,730	16,724,947	84,710	909,686
Kazakhstan Tenge	—	—	—	—
Korean Won	—	5,035	—	—
Malaysian Ringgit	876	469,335	—	—
Mexican Peso	5,029	680,019	—	165,770
Moroccan Dirham	18	4,060	—	—
New Romanian Leu	—	—	—	—
New Russian Ruble	—	3,480	—	—
New Taiwan Dollar	2,002	1,873,153	—	—
New Turkish Lira	114	214,762	—	—
New Zealand Dollar	500	119,667	—	61,343
Norwegian Krone	4,028	687,890	—	33,929
Pakistan Rupee	172	62,463	—	—
Peruvian Nouveau Sol	49	6,310	—	—
Philippine Peso	303	217,689	—	—
Polish Zloty	156	226,354	—	50,175
Singapore Dollar	2,878	1,159,550	—	5,560
South African Rand	2,242	1,466,853	—	5,719
South Korean Won	3,550	2,641,084	—	—
Sri Lanka Rupee	3	—	—	—
Swedish Krona	3,315	1,977,295	—	52,197
Swiss Franc	1,429	5,213,058	—	499
Thailand Baht	4,862	713,374	—	—
Tunisian Dinar	—	—	—	—
Turkish Lira	1,369	452,638	—	—
UAE Dirham	740	55,294	—	—
U.S. Dollar	—	737,552	—	—
Total investments subject to foreign currency risk	**$ 737,947**	**$ 93,982,104**	**$ 3,623,190**	**$ 5,908,467**

Real Estate	Spot Contracts	Forward Contracts	Total
$ —	$ —	$ 4	$ 4
209,224	—	53,970	5,358,489
—	—	—	3,292
1,145,374	(5)	532	2,928,353
274,143	431	27,077	15,339,389
597,809	13	34,061	7,055,592
—	—	—	5,084
—	—	(232)	250,108
679,066	—	486	683,195
—	(20)	55	64,236
—	—	733	79,012
—	—	(3,183)	904,345
—	—	(2)	58,477
738,749	601	32,546	31,460,319
72,029	—	—	72,029
415,541	2	(115)	4,834,567
—	—	75	129,576
383,684	(99)	434	1,522,591
—	(6)	916	583,196
—	—	(473)	308,459
279,406	1,020	(18,867)	18,140,632
—	—	1	1
—	—	—	5,035
22,221	6	448	492,886
179,333	7	(1,790)	1,028,368
—	—	(229)	3,849
—	—	(2)	(2)
225,238	7	3	228,728
—	—	245	1,875,400
—	—	—	214,876
—	—	(749)	180,761
2,530	—	4,550	732,927
—	—	—	62,635
—	6	21	6,386
—	—	(640)	217,352
—	—	134	276,819
8,888	(9)	4,127	1,180,994
—	17	661	1,475,492
—	30	(172)	2,644,492
123,069	—	—	123,072
—	—	11,822	2,044,629
—	(6)	(4,166)	5,210,814
—	(31)	14	718,219
—	—	32	32
—	(12)	(106)	453,889
—	—	—	56,034
—	—	—	737,552
$ 5,356,304	**$ 1,952**	**$ 142,221**	**$ 109,752,185**

C. Discretely Presented Component Units

The discretely presented component units consist of the University of California (University) and its foundations and the California Housing Finance Agency (CalHFA), and various funds that constitute 7% 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 CalHFA, and other component units is invested in the State Treasurer's pooled investment program.

The investments of the University, 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. Deposits with the State of California are valued at contract value, which the University believes approximates fair value. 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' investments that are invested with the University and managed by the University's Chief Investment Officer 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, 2013, 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, 2013, the securities in these pools had a weighted average maturity of 44 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, 2013
(amounts in thousands)

	Fair Value
Investment Type	
Equity securities	$ 3,421,693
Debt securities*	14,268,479
Investment contracts	105,614
Mutual funds	7,662,271
Real estate	725,786
Money market securities	1,389,147
Private equity	1,149,616
Mortgage loans	161,308
Securities lending collateral	1,468,865
Invested for others	(2,430,055)
Other	2,435,572
Total investments	**$ 30,358,296**

* 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%.

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, 2013

(amounts in thousands)

	University of California		University of California Foundations	
Investment Type	**Fair Value at Year End**	**Effective Duration[1]**	**Fair Value at Year End**	**Effective Duration[1]**
U.S. Treasury bills, notes, and bonds	$ 492,681	0.80	$ 320,825	1.60
U.S. Treasury strips	88,985	9.50	161	—
U.S. Treasury inflation-protected securities	151,225	7.00	—	—
U.S. government-backed securities	—	—	1,361	3.20
U.S. government-backed asset-backed securities	—	—	582	7.10
Corporate bonds	6,276,076	3.70	52,915	4.50
Commercial paper	2,205,533	—	—	—
U.S. agencies	1,383,842	2.90	3,996	5.00
U.S. agencies asset-backed securities	283,169	4.50	76,387	4.20
Corporate asset-backed securities	107,456	2.10	38,176	—
Supranational/foreign	1,700,003	4.10	1,691	0.80
Corporate (foreign currency denominated)	39,199	2.90	—	—
U.S. bond funds	150,696	4.90	157,748	4.40
Non-U.S. bond funds	19,564	4.50	56,108	5.20
Money market funds	680,674	—	628,690	2.60
Mortgage loans	161,054	—	254	—
Forward contracts on a to-be-announced basis	(10,604)	1.80	(170)	—
U.S. Treasury and agency securities	—	—	—	—
Other	14,101	16.80	13,305	4.50
Total	**$ 13,743,654**		**$ 1,352,029**	

[1] 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.

California Housing Finance Agency	
Fair Value at Year End	Effective Duration [1]
$ —	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
—	—
489,991	16.00
—	—
$ 489,991	

Table 12 identifies the debt securities that are highly sensitive to interest rate fluctuations 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, 2013

(amounts in thousands)

	University of California	
	Fair Value at Year End	**Effective Duration**
Mortgage-Backed Securities 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.	$ 334,374	4.10
Collateralized Mortgage Obligations Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the underlying mortgages are subject to a lower propensity of prepayments.	70,482	4.00
Other Asset-Backed Securities Other asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. As with CMOs, the relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates.	23,663	1.20
Variable-Rate Securities 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.	7,196	2.30
Callable Bonds Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates.	1,915,506	4.60
Convertible Bonds 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.	349	4.70

University of California Foundations	
Fair Value at Year End	Effective Duration
$ 56,375	1.30
27,905	0.50
9,168	1.20
—	—
551	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 U.S. Aggregate Bond Index, comprising approximately 27.5% high grade corporate bonds and 31.4% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 41.1% 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.

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, 2013
(amounts in thousands)

Credit Rating as of Year End Short-term	Long-term	Fair Value
A-1+	AAA	$ 282,419
A-1/P-1	AA2/AA	5,127,509
A-2	A2/A	3,791,788
A-3	BAA2/BBB	2,381,305
B	BA2/BB	315,441
B	B2/B	313,040
C	CC or below	84,197
Not rated		3,417,007
Total fixed-income securities		**$ 15,712,706**

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. For high-yield and emerging market debt, the corresponding limit is 5%. 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 and its Foundations – Foreign Currency Risk

June 30, 2013
(amounts in thousands of U.S. dollars at fair value)

Currency	Equity	Real Estate	Investment Derivatives	Fixed-Income	Total
Australian Dollar	$ 90,721	$ 1,021	$ 1,246	$ —	$ 92,988
Brazilian Real	—	—	—	4,718	4,718
British Pound Sterling	285,600	659	1,573	—	287,832
Canadian Dollar	109,096	—	582	—	109,678
Danish Krone	16,091	—	—	—	16,091
Euro	420,548	996	537	2,275	424,356
Hong Kong Dollar	59,945	2,457	—	—	62,402
Indonesian Rupiah	—	—	—	3,209	3,209
Japanese Yen	302,726	1,892	3,146	—	307,764
Malaysian Ringgit	—	—	—	3,573	3,573
Mexican Peso	—	—	—	4,638	4,638
New Russian Ruble	—	—	—	3,703	3,703
Norwegian Krone	13,656	—	—	—	13,656
Polish Zloty	—	—	—	3,450	3,450
Singapore Dollar	27,671	478	—	—	28,149
South African Rand	—	—	—	3,980	3,980
Swedish Krona	41,548	—	—	—	41,548
Swiss Franc	137,919	—	—	—	137,919
Turkish Lira	—	—	—	3,911	3,911
Other	52,309	3,328	460	5,742	61,839
Commingled currencies	1,390,125	—	—	65,225	1,455,350
Total investments subject to foreign currency risk	**$ 2,947,955**	**$ 10,831**	**$ 7,544**	**$ 104,424**	**$ 3,070,754**

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, 2013
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers
Current governmental activities			
General Fund	$ 11,527,389	$ —	$ —
Federal Fund	—	—	—
Transportation Fund	625,823	—	—
Environmental and Natural Resources Fund	—	—	—
Nonmajor governmental funds	338,760	—	—
Internal service funds	—	—	—
Total current governmental activities	**$ 12,491,972**	**$ —**	**$ —**
Amounts not expected to be collected during the subsequent year (unavailable revenue)	**$ 1,704,409**	**$ —**	**$ —**
Current business-type activities			
Water Resources Fund	$ —	$ —	$ —
Public Buildings Construction Fund	—	197,801	—
State Lottery Fund	—	—	362,744
Unemployment Programs Fund	—	—	—
California State University	—	—	—
Nonmajor enterprise funds	—	—	—
Adjustment:			
Account reclassification	—	(197,801)	—
Total current business-type activities	**$ —**	**$ —**	**$ 362,744**
Amounts not expected to be collected during the subsequent year (unavailable revenue)	**$ —**	**$ —**	**$ —**

[*] This amount includes noncurrent receivables for Service Concession Arrangements.

Unemployment Programs	California State University	Other	Total
$ —	$ —	$ 1,123,106	$ 12,650,495
—	—	950	950
—	—	434,469	1,060,292
—	—	505,457	505,457
—	—	1,958,218	2,296,978
—	—	45,665	45,665
$ —	**$ —**	**$ 4,067,865**	**$ 16,559,837**
$ —	**$ —**	**$ 267,333** *	**$ 1,971,742**
$ —	$ —	$ 92,373	$ 92,373
—	—	—	197,801
—	—	—	362,744
1,275,655	—	—	1,275,655
—	161,990	—	161,990
—	—	46,115	46,115
—	—	(662)	(198,463)
$ 1,275,655	**$ 161,990**	**$ 137,826**	**$ 1,938,215**
$ 30,476	**$ 272,644**	**$ —**	**$ 303,120**

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, 2013
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,718,509	$ 385,758	$ 20,448	$ 325,930	$ 2,450,645
Construction	2,292,203	11,889	—	—	2,304,092
Operations	228,000	—	—	—	228,000
Other	2,623	8,754	—	—	11,377
Total primary government	**4,241,335**	**406,401**	**20,448**	**325,930**	**4,994,114**
Discretely presented component units					
Debt service	124,877	26,134	—	—	151,011
Total discretely presented component units	**124,877**	**26,134**	—	—	**151,011**
Total restricted assets	**$ 4,366,212**	**$ 432,535**	**$ 20,448**	**$ 325,930**	**$ 5,145,125**

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 California State University Trust 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)

Year Ending June 30	Primary Government Agencies	University of California	California State University	Local Agencies	Total
2014	$ 627,900	$ 220,265	$ 29,402	$ 63,776	$ 941,343
2015	626,417	212,174	29,369	62,177	930,137
2016	622,440	178,630	26,753	53,892	881,715
2017	620,872	171,731	27,040	39,986	859,629
2018	590,803	188,278	27,122	32,698	838,901
2019-2023	2,339,505	857,584	141,276	77,765	3,416,130
2024-2028	1,854,657	600,460	148,792	63,379	2,667,288
2029-2033	1,186,734	416,440	131,503	39,021	1,773,698
2034-2038	270,758	59,510	42,746	—	373,014
2039-2043	—	—	23,190	—	23,190
2044-2046	—	—	8,986	—	8,986
Total minimum lease payments	**8,740,086**	**2,905,072**	**636,179**	**432,694**	**12,714,031**
Less: unearned income	3,334,459	1,029,616	253,826	102,721	4,720,622
Net investment in direct financing leases	**$ 5,405,627**	**$ 1,875,456**	**$ 382,353**	**$ 329,973**	**$ 7,993,409**

NOTE 7: CAPITAL ASSETS

Table 18 summarizes the capital activity for the primary government, which includes $8.0 billion in capital assets related to capital leases.

Table 18

Schedule of Changes in Capital Assets – Primary Government

June 30, 2013
(amounts in thousands)

	Beginning Balance (Restated)	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated/amortized				
Land	$ 17,112,444 *	$ 525,776	$ 36,165	$ 17,602,055
State highway infrastructure	63,779,198 *	1,011,463	171,224	64,619,437
Collections	22,528	119	2	22,645
Construction in progress	8,625,913 *	2,760,311	1,480,894	9,905,330
Intangible assets	1,022,313 *	336,133	274,118	1,084,328
Total capital assets not being depreciated/amortized	**90,562,396**	**4,633,802**	**1,962,403**	**93,233,795**
Capital assets being depreciated/amortized				
Buildings and improvements	19,065,903 *	1,172,929	15,683	20,223,149
Infrastructure	718,155	23,209	2,872	738,492
Equipment and other assets	4,505,430 *	283,245	136,667	4,652,008
Intangible assets	678,786 *	382,689	75,291	986,184
Total capital assets being depreciated/amortized	**24,968,274**	**1,862,072**	**230,513**	**26,599,833**
Less accumulated depreciation/amortization for:				
Buildings and improvements	6,398,655 *	153,741	12,755	6,539,641
Infrastructure	293,242	34,811	2,717	325,336
Equipment and other assets	3,698,714 *	333,512	129,126	3,903,100
Intangible assets	383,381 *	60,184	46,080	397,485
Total accumulated depreciation/amortization	**10,773,992**	**582,248**	**190,678**	**11,165,562**
Total capital assets being depreciated/amortized, net	**14,194,282**	**1,279,824**	**39,835**	**15,434,271**
Governmental activities, capital assets, net	**$ 104,756,678**	**$ 5,913,626**	**$ 2,002,238**	**$ 108,668,066**
Business-type activities				
Capital assets not being depreciated/amortized				
Land	$ 216,206	$ 714	$ 32	$ 216,888
Collections	2,895	3,183	27	6,051
Construction in progress	1,766,234 *	1,050,892	229,995	2,587,131
Intangible assets	311,527 *	93,125	673	403,979
Total capital assets not being depreciated/amortized	**2,296,862**	**1,147,914**	**230,727**	**3,214,049**
Capital assets being depreciated/amortized				
Buildings and improvements	10,176,625	282,554	7,248	10,451,931
Infrastructure	205,836	30,315	2	236,149
Equipment and other assets	558,023 *	54,356	36,048	576,331
Intangible assets	158,518 *	17,008	1,481	174,045
Total capital assets being depreciated/amortized	**11,099,002**	**384,233**	**44,779**	**11,438,456**
Less accumulated depreciation/amortization for:				
Buildings and improvements	3,908,907	261,734	5,878	4,164,763
Infrastructure	46,490	14,958	2	61,446
Equipment and other assets	331,177	50,805	34,167	347,815
Intangible assets	104,500 *	15,823	1,288	119,035
Total accumulated depreciation/amortization	**4,391,074**	**343,320**	**41,335**	**4,693,059**
Total capital assets being depreciated/amortized, net	**6,707,928**	**40,913**	**3,444**	**6,745,397**
Business-type activities, capital assets, net	**$ 9,004,790**	**$ 1,188,827**	**$ 234,171**	**$ 9,959,446**

* Restated

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

Table 19

Schedule of Depreciation Expense – Primary Government

June 30, 2013
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 69,301
Education	127,941
Health and human services	42,647
Resources	31,985
State and consumer services	37,316
Business and transportation	101,286
Correctional programs	122,610
Internal service funds (charged to the activities that utilize the fund)	49,162
Total governmental activities	**582,248**
Business-type activities	**343,320**
Total primary government	**$ 925,568**

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, 2013
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated/amortized				
Land	$ 902,283 *	$ 77,648	$ 9,225	$ 970,706
Collections	352,169	10,296	92	362,373
Construction in progress	2,805,485 *	131,798	19,741	2,917,542
Intangible assets	5,141 *	—	10	5,131
Total capital assets not being depreciated/amortized	**4,065,078**	**219,742**	**29,068**	**4,255,752**
Capital assets being depreciated/amortized				
Buildings and improvements	29,445,447 *	1,625,825	75,144	30,996,128
Infrastructure	656,560	10,244	5	666,799
Equipment and other depreciable assets	9,432,630 *	618,627	370,763	9,680,494
Intangible assets	490,308 *	207,741	23,507	674,542
Total capital assets being depreciated/amortized	**40,024,945**	**2,462,437**	**469,419**	**42,017,963**
Less accumulated depreciation/amortization for:				
Buildings and improvements	10,626,127 *	980,371	24,500	11,581,998
Infrastructure	283,069	22,839	—	305,908
Equipment and other depreciable assets	6,491,347 *	561,288	348,205	6,704,430
Intangible assets	259,251 *	60,888	20,158	299,981
Total accumulated depreciation/amortization	**17,659,794**	**1,625,386**	**392,863**	**18,892,317**
Total capital assets being depreciated/amortized, net	**22,365,151**	**837,051**	**76,556**	**23,125,646**
Capital assets, net	**$ 26,430,229**	**$ 1,056,793**	**$ 105,624**	**$ 27,381,398**

* 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 Position.

Table 21

Schedule of Accounts Payable

June 30, 2013

(amounts in thousands)

	Education	Health and Human Services
Governmental activities		
General Fund	$ 256,569	$ 790,098
Federal Fund	173,190	336,586
Transportation Fund	9,578	17
Environmental and Natural Resources Fund	2,994	3,339
Nonmajor governmental funds	13,155	546,717
Internal service funds	—	—
Adjustment:		
Fiduciary funds	8,490,297	9,649,692
Total governmental activities	**$ 8,945,783**	**$ 11,326,449**
Business-type activities		
Electric Power Fund	$ —	$ —
Water Resources Fund	—	—
Public Buildings Construction Fund	—	—
State Lottery Fund	—	—
Unemployment Programs Fund	—	—
California State University	169,394	—
Nonmajor enterprise funds	1,000	109
Adjustment:		
Fiduciary funds	—	—
Total business-type activities	**$ 170,394**	**$ 109**

Resources	**Business and Transportation**	**General Government and Others**	**Total**
$ 109,922	$ 1	$ 501,054	$ 1,657,644
63,558	548,733	107,040	1,229,107
4,516	388,510	14,291	416,912
316,755	630	4,316	328,034
10,547	74,151	341,132	985,702
17,329	—	247,403	264,732
—	99,248	513,750	18,752,987
$ 522,627	**$ 1,111,273**	**$ 1,728,986**	**$ 23,635,118**
$ 9,000	$ —	$ —	$ 9,000
106,490	—	—	106,490
—	—	200,200	200,200
—	—	60,505	60,505
—	—	7,200	7,200
—	—	—	169,394
8	—	3,003	4,120
—	—	381	381
$ 115,498	**$ —**	**$ 271,289**	**$ 557,290**

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, because General Fund revenues and disbursements do not occur 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 2012-13 fiscal year, the State issued $10.0 billion in RANs on August 16, 2012. The RANs were repaid during May and June of 2013.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2013, the primary government had long-term obligations totaling $170.8 billion. Of that amount, $6.4 billion is due within one year. The largest changes in long-term obligations for governmental activities are a decrease of $3.1 billion in loans payable and an increase of $3.1 billion in net other postemployment benefits obligations. Other notable increases occurred in general obligation bonds payable and certificates of participation and commercial paper payable.

As of June 30, 2013, the pollution remediation obligations decreased by $34 million, to $1.0 billion. 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, 2013, the State estimates that remediation costs at Stringfellow will total $378 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 final terms of the settlement 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 the claim's parameters and guidelines are 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 $3.3 billion for net pension obligations, $86 million owed for lawsuits, the University of California unfunded pension liability of $28 million, and the California Technology Agency notes payable of $27 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 changes in business-type long-term obligations are a decrease of $384 million for loans payable to the U.S. Department of Labor to cover shortfalls in the Unemployment Programs Fund and a decrease of $232 million in general obligation bonds payable.

Table 22 summarizes the changes in long-term obligations during the year ended June 30, 2013.

Table 22

Schedule of Changes in Long-term Obligations

(amounts in thousands)

	Balance July 1, 2012		Additions
Governmental activities			
Loans payable	$ 3,131,365		$ —
Compensated absences payable	3,820,093	*	1,771,537
Certificates of participation and commercial paper	43,228	*	643,865
Accreted interest	3,050		184
Certificates of participation and commercial paper payable	46,278	*	644,049
Capital lease obligations	4,936,200	*	710,440
General obligation bonds	79,447,815		7,417,170
Premiums/discounts/other	1,929,179	*	903,130
General obligation bonds payable	81,376,994	*	8,320,300
Revenue bonds	7,558,970		375,105
Accreted interest	334,176		49,686
Premiums/discounts/other	108,800	*	56,019
Revenue bonds payable	8,001,946	*	480,810
Net other postemployment benefits obligation	12,472,425	*	4,768,897
Pollution remediation obligations	1,043,047	*	35,028
Proposition 98 funding guarantee	2,247,676		134,862
Mandated costs	6,414,082		416,988
Workers' compensation	3,202,772		754,641
Other long-term obligations	3,368,459		328,503
Total governmental activities	**$ 130,061,337**		**$ 18,366,055**
Business-type activities			
Loans payable	$ 8,968,936		$ —
Lottery prizes and annuities	1,306,053		2,844,588
Compensated absences payable	297,336		137,887
Certificates of participation and commercial paper	67,325		149,366
Capital lease obligations	817,687		92,184
General obligation bonds	1,119,935		—
Premiums/discounts/other	(1,301)		74
General obligation bonds payable	1,118,634		74
Revenue bonds	24,482,048		3,022,400
Premiums/discounts/other	912,690		343,367
Revenue bonds payable	25,394,738		3,365,767
Net other postemployment benefits obligation	410,782		157,165
Other long-term obligations	526,167	*	46,563
Total business-type activities	**$ 38,907,658**		**$ 6,793,594**

* Restated

Deductions	Balance June 30, 2013	Due Within One Year	Noncurrent Liabilities
$ 3,131,365	$ —	$ —	$ —
1,456,529	4,135,101	19,500	4,115,601
148,500	538,593	8,094	530,499
3,234	—	—	—
151,734	538,593	8,094	530,499
327,153	5,319,487	399,491	4,919,996
7,176,540	79,688,445	2,900,795	76,787,650
174,543	2,657,766	139,709	2,518,057
7,351,083	82,346,211	3,040,504	79,305,707
726,158	7,207,917	158,398	7,049,519
—	383,862	—	383,862
21,545	143,274	(4,267)	147,541
747,703	7,735,053	154,131	7,580,922
1,682,090	15,559,232	—	15,559,232
68,859	1,009,216	35,259	973,957
468,474	1,914,064	—	1,914,064
80,221	6,750,849	54,259	6,696,590
449,937	3,507,476	413,644	3,093,832
277,990	3,418,972	57,243	3,361,729
$ 16,193,138	**$ 132,234,254**	**$ 4,182,125**	**$ 128,052,129**
$ 383,618	$ 8,585,318	$ —	$ 8,585,318
2,951,737	1,198,904	491,123	707,781
121,090	314,133	124,925	189,208
139,131	77,560	340	77,220
—	909,871	62,519	847,352
231,655	888,280	61,185	827,095
—	(1,227)	—	(1,227)
231,655	887,053	61,185	825,868
3,041,490	24,462,958	1,338,210	23,124,748
160,886	1,095,171	140,893	954,278
3,202,376	25,558,129	1,479,103	24,079,026
57,718	510,229	—	510,229
88,081	484,649	24,842	459,807
$ 7,175,406	**$ 38,525,846**	**$ 2,244,037**	**$ 36,281,809**

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
2014	$ 8,140	$ 1,503	$ 9,643
2015	8,565	1,075	9,640
2016	11,915	625	12,540
Total	**$ 28,620**	**$ 3,203**	**$ 31,823**

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" agreements for the general obligation commercial paper program, effective December 21, 2011, authorize the issuance of notes in an aggregate principal amount not to exceed $1.6 billion. As of June 30, 2013, the general obligation commercial paper program had $510 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, 2013, the enterprise fund commercial paper program had $51 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, 2013, $27 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 may be issued by the University to provide for interim/permanent financing for capital projects and interim financing for equipment and working capital. Commercial paper is collateralized 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, 2013, outstanding tax-exempt and taxable commercial paper totaled $55 million and $1.3 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. Outstanding borrowings under these uncollateralized financing agreements for the period ending June 30, 2013, total $262 million for general corporate purposes and $15 million for interim financing.

NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2013, was approximately $10.7 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 $6.2 billion. 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, 2013, amounted to approximately $1.0 billion.

Included in the capital lease commitments are lease-purchase agreements, amounting to a present value of net minimum lease payments of $5.6 billion that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency. This amount represents 90.6% 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 $309 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	Total
2014	$ 279,348	$ 728,216	$ 1,007,564
2015	188,056	714,784	902,840
2016	125,375	698,504	823,879
2017	80,589	682,721	763,310
2018	40,063	657,030	697,093
2019-2023	79,622	2,595,057	2,674,679
2024-2028	14,924	2,038,819	2,053,743
2029-2033	11,578	1,362,162	1,373,740
2034-2038	3,063	362,421	365,484
2039-2043	1,567	9,715	11,282
2044-2048	498	—	498
2049-2053	352	—	352
2054-2058	114	—	114
2059-2063	52	—	52
2064-2068	32	—	32
2069-2073	33	—	33
2074-2078	32	—	32
2079-2083	33	—	33
2084-2088	32	—	32
2089-2093	33	—	33
2094-2098	32	—	32
2099-2103	3	—	3
Total minimum lease payments	**$ 825,431**	**9,849,429**	**$ 10,674,860**
Less: amount representing interest		3,620,071	
Present value of net minimum lease payments		**$ 6,229,358**	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2013, was approximately $4.5 billion. Table 25 presents the future minimum lease commitments for the University of California. Operating lease expenditures for the year ended June 30, 2013, amounted to approximately $168 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		
	Capital	Operating	Total
2014	$ 313,074	$ 120,281	$ 433,355
2015	267,337	97,810	365,147
2016	239,951	80,610	320,561
2017	235,463	65,363	300,826
2018	228,809	54,160	282,969
2019-2023	1,072,137	131,171	1,203,308
2024-2028	785,675	7,223	792,898
2029-2033	596,047	4,932	600,979
2034-2038	129,122	4,898	134,020
2039-2043	30,977	1,651	32,628
2044-2048	3,968	—	3,968
Total minimum lease payments	**3,902,560**	**$ 568,099**	**$ 4,470,659**
Less: amount representing interest	1,316,171		
Present value of net minimum lease payments	**$ 2,586,389**		

NOTE 14: COMMITMENTS

As of June 30, 2013, the primary government had commitments of $7.0 billion for certain highway construction projects. The primary government also had commitments of $773 million for various education programs, $489 million for terrorism prevention and disaster preparedness response projects, $329 million for services provided under various public health programs, $291 million for services under the workforce development program, $202 million for community service programs, $126 million for services provided under the welfare program, $40 million for services provided under the child support program, and $33 million for services provided under the rehabilitation program.

The primary government had other commitments, totaling $7.6 billion that are not included as a liability on the Balance Sheet or the Statement of Net Position. The $7.6 billion in commitments includes grant agreements totaling approximately $5.5 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 $7.6 billion in commitments includes $363 million in undisbursed loan commitments for various programs aimed at providing housing and emergency shelter to persons in need. In addition, the $7.6 billion in commitments includes $113 million in long-term contracts to purchase power. These contracts qualify for the Normal Purchase Normal Sale (NPNS) exception under GASB Statement No. 53 and, therefore, are not included on the Statement of Net Position of the Electric Power Fund nor disclosed in Note 17.

The $7.6 billion in commitments also includes contracts of $861 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 Position of the Water Resources Fund. Included in this amount are certain power purchase, sale, and exchange contracts. These contracts had a positive fair value of $72,000 as of June 30, 2013. The primary government had commitments of $214 million for California State University (CSU) construction projects. CSU participates in forward-purchase contracts of natural gas and electricity. As of June 30, 2013, CSU's obligation under these special purchase arrangements requires it to purchase at fixed prices an estimated total of $26 million in electricity through March 2014 and $35 million in natural gas through June 2017. The primary government also had commitments of $5 million to veterans for the purchase of properties under contracts of sale. The California State Lottery Commission had commitments of $533 million, of which $530 million is for gaming and telecommunication systems and services and $3 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, 2013, the primary government encumbered expenditures of $658 million for the General Fund, $3.9 billion for the Transportation Fund, $1.2 billion for the Environmental and Natural Resources Fund, and $708 million for the nonmajor governmental funds. See Note 2A for an explanation of the primary government's policy concerning encumbrances.

As of June 30, 2013, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Position. The University of California had authorized construction projects totaling $3.4 billion. The University also made commitments to invest in certain investment partnerships pursuant to provisions in the various partnership agreements. These commitments totaled $700 million as of June 30, 2013. 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 $12.4 billion and commitments to purchase real estate equity of $8.0 billion that remained unfunded and not recorded as liabilities on the Statement of Net Position of the fiduciary 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 vote 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, 2013, the State had $79.7 billion in outstanding general obligation bonds related to governmental activities and $888 million related to business-type activities. In addition, $30.5 billion of long-term general obligation bonds had been authorized but not issued, of which $29.2 billion is related to governmental activities and $1.3 billion is related to business-type activities. The total amount authorized but not issued includes $17.9 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $510 million in general obligation indebtedness in the form of commercial paper notes was not yet retired by long-term bonds.

A. Variable-rate General Obligation Bonds

The State issues both fixed and variable-rate general obligation bonds. As of June 30, 2013, the State had $2.7 billion of 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. The State has entered into different credit agreements with various banks for each series of credit enhanced bonds. Under these credit agreements, the credit providers agree to pay all principal and interest payments or the commitment amounts to the bondholders; the State is then required to reimburse the credit providers for the amounts paid. In return, the credit providers are compensated with commitment fees that are calculated as a percentage of the bank commitment amounts. The bondholders have the right to tender the bonds daily if the bonds are in a daily rate mode and weekly if the bonds are in a weekly rate mode. Upon a tender, the remarketing agent will attempt to remarket the bonds to a new investor. If the remarketing of the bonds is unsuccessful, the bonds will enter into a bank bond period and accrue interest at higher rates— which cannot exceed 11% as permitted by law until remarketed or redeemed. If the bonds cannot be remarketed and remain in a bank bond period ranging from 45 days to 180 days, the bonds will be subject to term loan payment in 12 equal quarterly installments under the terms stated in the credit agreements. The term loan period may exceed the expiration dates of the credit agreements. The bonds may be remarketed at any time during the bank bond or term loan period. There were no bank bonds during fiscal year 2012 - 2013.

The letters of credit for the variable-rate bonds issued during the 2002-03 fiscal year have expiration dates of November 21, 2014; December 1, 2014; October 15, 2015; and October 16, 2015. The letters of credit for the variable-rate bonds issued during the 2004-05 fiscal year have expiration dates of April 6, 2015; October 12, 2015; and October 15, 2015. 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. The Series 2012A SIFMA Index floating rate bonds have a mandatory purchase date of May 1, 2015. The Series 2012B SIFMA Index floating rate 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, 2013, the State had $5.2 billion in Economic Recovery Bonds outstanding. Of the $5.2 billion outstanding, bonds totaling $260 million are variable-rate bonds in the daily-rate mode and $500 million are mandatory tender bonds. 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 for the variable-rate bonds, 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. 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 $5.2 billion in outstanding Economic Recovery Bonds, $500 million are mandatory tender bonds and have an interest rate reset date 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% 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.

In May 2012, the State issued $100 million in General Obligation Kindergarten-University Public Education Facilities Refunding Bonds, Series 2012A (SIFMA Index Floating Rate Bonds). The mandatory bonds have an initial SIFMA scheduled mandatory purchase date of May 1, 2015. The bonds will bear interest at a per annum interest rate, determined weekly (not to exceed 11%), and equal to the sum of the SIFMA Index rate in effect and the applicable SIFMA spread of 0.68%. In the event of unsuccessful remarketing of all the outstanding bonds on the initial SIFMA scheduled mandatory purchase date, the bonds will enter into a SIFMA delayed remarketing period and the bonds will accrue interest at a higher rate to be paid by the State until remarketed or redeemed. Starting six months after the SIFMA— scheduled mandatory purchase date, the bonds will be subject to special mandatory redemption in 20 equal quarterly installments.

D. Build America Bonds

As of June 30, 2013, 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. The bonds will mature between 2020 and 2040. 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 American Taxpayer Relief Act of 2012 effective March 1, 2013, reduced the Build America Bonds subsidy by 8.7% for the federal fiscal year ending September 30, 2013. 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 deposited into the state treasury.

E. Debt Service Requirements

Table 26 shows the debt service requirements for all general obligation bonds as of June 30, 2013. The estimated debt service requirements for the $2.7 billion variable-rate general obligation bonds and the $260 million variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2013. 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	**Governmental Activities**			**Business-type Activities**		
June 30	**Principal**	**Interest**	**Total**	**Principal**	**Interest**	**Total**
2014	$ 2,900,795	$ 4,089,281	$ 6,990,076	$ 61,185	$ 38,861	$ 100,046
2015	3,136,045	3,993,769	7,129,814	77,565	35,964	113,529
2016	3,303,620	3,865,978	7,169,598	75,620	32,851	108,471
2017	2,757,990	3,711,780	6,469,770	61,895	30,150	92,045
2018	2,823,120	3,594,810	6,417,930	60,655	27,463	88,118
2019-2023	15,340,120	15,734,172	31,074,292	129,790	109,911	239,701
2024-2028	11,180,185	12,693,358	23,873,543	67,940	91,029	158,969
2029-2033	12,820,465	9,823,751	22,644,216	204,940	58,805	263,745
2034-2038	15,570,625	5,852,792	21,423,417	98,285	22,243	120,528
2039-2043	9,855,480	1,398,049	11,253,529	50,405	3,550	53,955
Total	**$79,688,445**	**$64,757,740**	**$144,446,185**	**$ 888,280**	**$ 450,827**	**$1,339,107**

F. General Obligation Bond Defeasances

1. Current Year

On October 4, 2012, the primary government issued $776 million in general obligation refunding bonds to current and advance refund $867 million in outstanding general obligation bonds maturing in 2013 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 $155 million and resulted in an economic gain of $117 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 2.93% per year over the life of the new bonds.

On November 1, 2012, the primary government issued $539 million in general obligation refunding bonds to current and advance refund $583 million in outstanding general obligation bonds maturing in 2020 to 2032. 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 $165 million and resulted in an economic gain of $119 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 3.01% per year over the life of the new bonds.

On March 27, 2013, the primary government issued $1.1 billion in general obligation refunding bonds to current and advance refund $1.2 billion in outstanding general obligation bonds maturing in 2014 to 2033. 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 $224 million and resulted in an economic gain of $169 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 3.11% per year over the life of the new bonds.

On March 27, 2013, the primary government issued $277 million in general obligation refunding bonds to current refund $277 million in outstanding mandatory tender general obligation bonds maturing in 2039. 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 restructure the debt of the State.

On April 23, 2013, the primary government issued $1.4 billion in general obligation refunding bonds to current and advance refund $1.5 billion in outstanding general obligation bonds maturing in 2013 to 2033. 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 $315 million and resulted in an economic gain of $237 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 2.94% per year over the life of the new bonds.

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, 2013, the outstanding balance of general obligation bonds defeased in prior years was approximately $4.9 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 $226 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 Position.

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 and the 2013 Bonds that refunded a portion 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 monies has never been required. Total principal and interest remaining on all asset-backed bonds is $19.3 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 $932 million, while Tobacco Settlement Revenue and interest earned totaled $555 million. These bonds are included in the governmental activities column of the government-wide Statement of Net Position.

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 Position.

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 buildings 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 remarketed rates or common indices, such as the 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, 2013
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Fund	$	227,886
Nonmajor governmental funds		
Golden State Tobacco Securitization Corporation Fund		7,185,762
Building authorities		321,405
Total governmental activities		**7,735,053**
Business-type activities		
Electric Power Fund		6,951,000
Water Resources Fund		2,594,459
Public Buildings Construction Fund		11,756,473
California State University		3,738,697
Nonmajor enterprise funds		517,500
Total business-type activities		**25,558,129**
Total primary government		**33,293,182**
Discretely presented component units		
University of California		12,801,508
California Housing Finance Agency		4,899,970
Nonmajor component units		382,174
Total discretely presented component units		**18,083,652**
Total	**$**	**51,376,834**

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)

	Primary Government				**Discretely Presented Component Units**	
Year Ending June 30	**Governmental Activities**		**Business-type Activities**			
	Principal	**Interest**	**Principal**	**Interest***	**Principal**	**Interest***
2014	$ 158,398	$ 350,681	$ 1,338,210	$ 1,197,986	$ 654,161	$ 795,433
2015	132,848	342,952	1,405,425	1,135,303	396,103	765,942
2016	70,973	336,423	1,493,415	1,070,249	446,987	743,498
2017	107,213	332,910	1,554,375	1,000,572	423,416	721,169
2018	88,988	327,648	1,611,765	926,167	428,417	698,753
2019-2023	461,328	1,570,793	7,460,488	3,449,345	2,803,720	3,150,819
2024-2028	791,964	1,658,847	4,067,145	2,042,169	2,661,734	2,531,030
2029-2033	775,760	1,348,169	3,393,135	1,030,137	3,028,880	1,886,242
2034-2038	1,425,390	1,603,159	1,815,025	286,963	2,855,257	1,223,788
2039-2043	—	818,939	315,380	34,282	2,287,268	648,567
2044-2048	3,578,917	3,701,239	8,595	391	724,132	339,695
2049-2053	—	—	—	—	91,435	215,351
2054-2112	—	—	—	—	860,000	2,464,948
Total	**$ 7,591,779**	**$ 12,391,760**	**$ 24,462,958**	**$ 12,173,564**	**$ 17,661,510**	**$ 16,185,235**

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2013.

D. Revenue Bond Defeasances

1. Current Year–Governmental Activities

On April 9, 2013, Enhanced Tobacco Settlement Asset-backed Bonds, Series 2013A, were issued to partially refund, on a current basis, a portion of the remaining outstanding bonds of the 2005A Bonds. On April 9, 2013, $375,105,000 principal value in current interest bonds with maturity dates ranging from June 1, 2017 through June 1, 2030 were sold at a $56,019,304 premium to partially refund $419,885,000 in principal value of Series 2005A bonds maturing in June 1, 2013, 2017, 2018, 2019, 2020, 2021, 2029, and 2030. The Golden State Tobacco Securitization Corporation completed the refunding to reduce debt service payments by $44,780,000 in aggregate and to obtain an economic gain (difference between the present value of the old and new debt service payments) of $1,268,860 in aggregate.

2. Current Year–Business-type Activities

In 2012-13, the Department of Water Resources issued $657 million in water system revenue bonds. The bonds proceeds were used to refund $632 million of 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 $93 million over the life of the bonds and will result in an economic gain of $77 million for the refunded bonds. These water system revenue bonds are reported in the Water Resources Fund.

For the year ended June 30, 2013, the State Public Works Board issued $506 million in lease revenue refunding bonds. The bonds proceeds were used to refund $577 million in outstanding lease 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 $95 million over the next 10 years and will result in an economic gain of $75 million for the refunded bonds. These lease revenue bonds are reported in the Public Buildings Construction Fund.

In August 2012, California State University issued $436 million in Systemwide Revenue Bonds refunding bonds to partially defease certain outstanding Systemwide Revenue Bonds. A portion of 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 $80 million over the life of the bonds and will result in an economic gain of $53 million for the refunded bonds.

3. Current Year–Discretely Presented Component Units

In July 2012, Limited Project Revenue Bonds totaling $1.0 billion, including $899 million in tax-exempt and $101 million in taxable bonds, were issued. Proceeds including a bond premium of $153 million were used to finance certain facilities and projects of the University and refund $854 million of outstanding Limited Project Revenue Bonds and outstanding General Revenue Bonds. The bonds mature at various dates through 2042. The tax-exempt bonds have a stated weighted average interest rate of 4.9%. The taxable bonds have a stated weighted average interest rate of 4.1%. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

In October 2012, General Revenue Bonds totaling $2 million, consisting of Taxable Clean Renewable Energy Bonds, were issued to pay for project construction and issuance costs. The bonds mature in 2022 and have a stated interest rate of 3%. The expected cash subsidy payment from the United States Treasury is equal to 100% of the posted tax credit rate.

In March 2013, General Revenue Bonds totaling $1.3 billion, including $806 million in tax-exempt and $501 million in taxable bonds, were issued. Proceeds including a bond premium of $137 million were used to refund $1.4 billion outstanding General Revenue Bonds. The bonds mature at various dates through 2039. The tax-exempt bonds have a stated weighted average interest rate of 4.7%. The taxable bonds have a stated weighted average interest rate of 3.5%. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

In March 2013, General Revenue Bonds totaling $287 million in taxable fixed-rate notes were issued. Proceeds were used to refund $287 million of outstanding General Revenue Bonds. The taxable fixed-rate notes have a stated interest rate of 1.8%, maturing in 2019.

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, 2013, the outstanding balance of revenue bonds defeased in prior years was $1.4 billion for business-type activities. All previously defeased revenue bonds for governmental activities were redeemed by June 30, 2013.

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, 2013, the outstanding balance of University revenue bonds defeased in prior years was $227 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, or foreign currency at a set price on a future date. Futures 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 to 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, 2013, 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)

	Discretely Presented Component Units			
Year Ending June 30	**Principal**	**Interest***	**Interest-Rate* Swap Net**	**Total**
2014	$ 15,790	$ 6,497	$ 80,000	$ 102,287
2015	15,975	6,150	73,971	$ 96,096
2016	19,350	6,154	68,355	$ 93,859
2017	21,080	6,132	63,220	$ 90,432
2018	29,525	6,118	58,744	$ 94,387
2019-2023	232,825	29,722	239,574	$ 502,121
2024-2028	235,770	27,898	175,020	$ 438,688
2029-2033	448,515	25,678	111,015	$ 585,208
2034-2038	371,377	23,382	45,833	$ 440,592
2039-2043	735,788	9,278	10,224	$ 755,290
2044-2048	17,120	206	2,266	$ 19,592
Total	**$ 2,143,115**	**$ 147,215**	**$ 928,222**	**$ 3,218,552**

* Based on rates in effect on June 30, 2013.

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, 2013
(dollars in thousands)

	Classification	Fair Value	Notional Amount (in MMBtu) [1]
Effective hedges			
Natural gas swaps	Other current liabilities	$ (2,000)	460,000
Total effective hedges		**$ (2,000)**	

[1] Millions of British thermal units.

1. Natural Gas Swaps and Options

As of June 30, 2013, DWR no longer has outstanding natural gas option contracts. In prior years, DWR entered into natural gas hedge contracts, futures, and options to hedge the cost of natural gas. All natural gas options were treated as derivatives and classified as investment derivatives.

The DWR no longer has any forward natural gas purchase contracts. In prior years, most of the DWR's natural gas purchases were treated as Normal Purchase Normal Sale (NPNS) contracts and were not recorded prior to settlement. Natural gas forwards not qualifying as NPNS were recorded at fair value on the Statement of Net Position. Changes in the fair value of derivatives that are classified as investment derivatives are included as investment income or loss on the Statement of Revenues, Expenses, and Changes in Fund Net Position.

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, 2013, 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, 2013, 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 forward rate at June 30, 2013.

All fiduciary fund derivative instruments are included in the investments disclosed in Note 3, Deposits and Investments. Changes in fair value are recorded as net appreciation or depreciation in fair value of investments in the Statement of Changes in Fiduciary Net Position. 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, 2013
(dollars in thousands)

	Net Appreciation (Depreciation)		Fair Value	Notional	
Investment Type	**in Fair Value**	**Classification**	**Amount**	**Dollars**	**Units/Shares**
Commodity futures long	$ (23,856)	Equity securities	$ —	$ —	—
Commodity futures long	(1,010)	Futures	—	28,073	—
Commodity futures short	(10,501)	Equity securities	—	—	—
Credit default swaps	(128)	Debt securities	(663)	39,969	—
Credit default swaps bought	(1,265)	Debt securities	(29)	12,800	—
Credit default swaps written	706	Debt securities	(104)	14,043	—
Fixed-income futures long	(7,963)	Equity securities	—	—	490,578
Fixed-income futures short	18,011	Equity securities	—	—	(522,652)
Fixed-income options bought	568	Equity securities	—	—	—
Fixed-income options written	(25,892)	Equity securities	(8,164)	—	(289,244)
Foreign currency forwards	32,091	Foreign currency contracts	13,151	9,265,383	—
Foreign currency options bought	413	Equity securities	—	—	—
Foreign currency options written	66	Equity securities	(59)	—	(3,424)
Foreign exchange forwards	382,233	Investment sales/purchases	129,070	23,450,446	—
Futures (domestic and foreign)	49,728	Futures	—	301,589	—
Futures options bought	(27,431)	Equity securities	877	—	4,600
Futures options written	25,358	Equity securities	(2,380)	—	(15,300)
Index futures long	2,338,736	Equity securities	—	—	71,240
Index options bought	(15,939)	Equity securities	—	—	150,000
Index options written	68,372	Equity securities	(1)	—	(150,000)
Interest rate swaps	(2,944)	Debt securities	—	—	—
Options	(5,008)	Debt securities	36,135 [1]	208,461	—
Pay fixed interest rate swaps	379	Debt securities	3,206	100,800	—
Receive fixed interest rate swaps	(1,724)	Debt securities	(1,796)	72,953	—
Rights	(10,953)	Equity securities	3,074	—	14,990
Rights	(4,369)	Equity securities	897	—	1,438 *
Total return bond swaps	(37,338)	Debt securities	(3,655)	4,156,814	—
Warrants	11,517	Equity securities	13,494	—	9,398
Warrants	956	Equity securities	1,174	—	269 *
Total	**$ 2,752,813**		**$ 184,227**	**$ 37,651,331**	**(238,107)**

[1] The total options of $36,135 is comprised of options bought and options written of $55,023 and $(18,888), respectively.

* Items with an asterisk are shares and those without are units.

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, 2013
(amounts in thousands)

Investment Type	Fair Value	Investment Maturities (in years) Under 1	1-10	10+
Credit default swaps	$ (663)	$ —	$ (663)	$ —
Credit default swaps bought	(29)	(2)	(27)	—
Credit default swaps written	(104)	—	(104)	—
Fixed-income options	33,000	—	33,000	—
Fixed-income options written	(8,164)	(8,164)	—	—
Pay fixed-interest-rate swaps	3,206	—	3,206	—
Receive fixed-interest-rate swaps	(1,796)	—	(1,971)	175
Total return bond swaps	(3,655)	(3,655)	—	—
Total	**$ 21,795**	**$ (11,821)**	**$ 33,441**	**$ 175**

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, 2013
(amounts in thousands)

Investment Type	Reference Rate	Fair Value	Notional Amount
Interest-rate swaps	Receive variable 3-month LIBOR[1], pay fixed 1.694%	$ 2,251	$ 29,720
	Receive variable 3-month LIBOR, pay fixed 1.400%	73	30,600
	Receive variable 3-month LIBOR, pay fixed 0.985%	592	27,220
	Receive variable 3-month LIBOR, pay fixed 0.764%	290	13,260
	Receive fixed 2.000%, pay variable 6-month LIBOR	175	10,872
	Receive fixed 1.000%, pay variable 6-month LIBOR	3	9,765
	Receive fixed 3.795%, pay variable 3-month BKBM[3]	(144)	2,471
	Receive fixed 2.0425%, pay variable 3-month LIBOR ...	(581)	10,850
	Receive fixed 0.430%, pay variable 3-month LIBOR	(9)	16,370
	Receive fixed 5.750%, pay variable 1-month TIIE[2]	(897)	15,201
	Receive fixed 5.750%, pay variable 1-month TIIE	(346)	5,865
	Receive fixed 5.500%, pay variable 1-month TIIE	3	1,559
Subtotal Interest-rate swaps		**$ 1,410**	**$ 173,753**
Fixed-income options			
Bought:	Swaption 10YR RTP Jan 23 3.9 PUT	$ 7,551	$ 100,000
	Swaption 10YR RTP May 23 4.06 PUT	13,990	200,000
	Swaption 10YR RTP Sept 19 3.13 PUT	28,625	250,000
Written:	Swaption 10YR RTP Jan 15 3.54 PUT	(3,729)	(100,000)
	Swaption 10YR RTP May 15 4.0575 PUT	(7,373)	(250,000)
	Swaption 10YR RTP May 15 4.025 PUT	(6,064)	(200,000)
Subtotal Fixed-income options		**$ 33,000**	**$ —**
Return bond swaps	Receive fixed 0.08%, pay fixed 0.00%	$ (624)	$ 266,544
	Receive fixed 0.07%, pay fixed 0.00%	(828)	353,994
	Receive fixed 0.00%, pay fixed 0.80%	(1,709)	1,232,297
	Receive fixed 0.00%, pay fixed 0.07%	(818)	2,165,395
	Receive fixed 0.00%, pay fixed 0.00%	324	138,584
Subtotal Return bond swaps		**$ (3,655)**	**$ 4,156,814**
	Total	**$ 30,755**	**$ 4,330,567**

[1] London Interbank Offered Rate (LIBOR)

[2] Tasa de Interes Interbancaria de Equilibrio (TIIE)

[3] New Zealand's Bank Bill Benchmark (BKBM)

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 exposure and 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, 2013

Counterparty	Percent of Net Exposure	S&P Ratings	Fitch Ratings	Moody's Ratings
Bank of America, N.A.	22.42 %	A	A	A3
JP Morgan Chase Bank, N.A. New York	15.66	A+	A+	Aa3
HSBC Bank USA	8.67	AA-	AA-	A1
Goldman Sachs International	8.60	A-	A	A3
Commonwealth Bank of Australia Sydney	7.23	AA-	AA-	Aa2
Bank of New York	4.67	A+	AA-	Aa3
Barclays Bank PLC Wholesale	4.66	A+	A	A2
Royal Bank of Canada	3.88	AA-	AA	Aa3
Citibank, N.A.	3.85	A	A	A3
BNP Paribas SA	3.17	A+	A+	A2
Morgan Stanley Capital Services Inc.	2.38	A-	A	Baa1
Royal Bank of Scotland PLC	2.36	A	A	A3
UBS AG	1.95	A	A	A2
Societe Generale	1.94	A	A+	A2
Standard Chartered Bank	1.91	AA-	AA-	A1
Deutsche Bank AG London	1.66	A+	A+	A2
JP Morgan Securities Inc.	1.13	A	A+	A2
Credit Suisse International	1.06	A+	A	A1
Goldman Sachs + CO	0.74	A-	A	A3
Credit Suisse London Branch (GFX)	0.42	A+	A	A1
UBS AG London	0.33	A	A	A2
Credit Suisse Securities (USA) LLC	0.28	A+	A	A1
JP Morgan	0.28	A	A+	A2
Canadian Imperial Bank of Commerce	0.16	A+	AA-	Aa3
Deutsche Bank Securities	0.15	A+	A+	A2
Citigroup	0.13	A-	A	Baa2
Westpac Banking Corp	0.12	AA-	AA-	Aa2
BNP Finance	0.10	A+	A+	A2
Barclays Capital	0.03	A+	A	A2
Goldman Sachs Capital Markets LP	0.03	A-	A	A3
JP Morgan Chase Bank, N.A. London	0.02	A+	A+	Aa3
JP Morgan Chase Bank	0.01	A+	A+	Aa3
Barclays Bank CME	0.00 [1]	A+	A	A2

[1] The Percentage of Net Exposure for Conterparty Barclays Bank CME is less than 0.01%.

In cases where a wholly owned broker-dealer subsidiary does not engage the rating companies for a stand-alone 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, 2013, the aggregate amount of cash collateral held at CalSTRS on behalf of the non-exchange-traded derivatives was $35 million. The aggregate fair value of investment derivative instruments in an asset position subject to counterparty credit risk at June 30, 2013, was $22 million. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted.

Table 35 depicts the counterparty credit ratings of CalSTRS non-exchange traded investment derivative instruments outstanding and subject to loss at June 30, 2013. The ratings used to determine the quality of the individual counterparty are the ratings with the highest degree of risk supplied by two nationally recognized statistical rating organizations (NRSROs).

Table 35

Schedule of Counterparty Credit Rating – California State Teachers' Retirement System
June 30, 2013
(amounts in thousands)

Ratings	Credit Default Swaps	Foreign Currency Forwards	Total
AA	$ —	$ 2,483	$ 2,483
A	312	19,223	19,535
Subtotal investments in asset position	**312**	**21,706**	**22,018**
Investments in liability position	(975)	(8,555)	(9,530)
Total investments in asset/ (liability) position	**$ (663)**	**$ 13,151**	**$ 12,488**

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 within their 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 which are derivative instruments that meet the criteria for an effective hedge. Certain 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. These swaps are comprised of derivative instruments, at-the-market swaps that are an effective hedge, and companion investments (a borrowing represented by up-front payment). The unamortized amount of the borrowing under the companion instrument was $29 million at June 30, 2013. 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) in the Statement of Net Position. 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, 2013
(amounts in thousands)

	Changes in Fair Value	Classification	Fair Value	Notional Amount
Investment derivatives				
Domestic equity futures contracts long	$ (7,460)	Investments	$ (2,470)	$ 603,484
Domestic equity futures contracts short	69	Investments	6	(1,200)
Foreign equity futures contracts long	97,622	Investments	493	52,193
Foreign equity futures contracts short	(181)	Investments	—	—
Foreign currency exchange contracts long	6,185	Investments	(296)	2,109,761
Foreign currency exchange contracts short	29,183	Investments	6,947	(16,323,059)
Swaps fixed interest rate	8,968	Investments	(21,367)	550,000
Swaps total return equity	(19)	Investments	(79)	7
Stock rights/warrants	286	Investments	5,179	609
Options/swap	(458)	Investments	983	3,781
Total investment derivatives	**$ 134,195**		**$ (10,604)**	**$ (13,004,424)**
Cash flow hedges				
Interest-rate swaps Pay fixed, receive variable	$ 23,737	Other noncurrent assets (liabilities)	$ (45,758)	$ 204,995

Table 29 presents the State's debt service requirements and net swap payments as of June 30, 2013. Included in these amounts are the University's principal, variable interest, and interest-rate net swap payments in the amounts of $879 million, $124 million, and $136 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 some of its variable-rate Medical Center Pooled Revenue Bonds. The University has determined that a portion of its interest-rate swaps are derivative instruments that meet the criteria for an effective hedge.

Fair Value: The swaps have an estimated negative fair value of $46 million as of June 30, 2013. 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, 2013
(amounts in thousands)

Swap Termination Date	Effective Date	Outstanding Notional Amount at June 30, 2013	Fair Value at June 30, 2013	Fixed Rate Paid by University of California	Variable Rate Received by University of California	Counterparty Credit Ratings (Moody's, S&P's)
2032	2007	$ 80,220	$ (11,135)	3.5897 %	58% of 1-Month LIBOR* + 0.48%	Baa2, A-
2030 through 2043	2008	124,775	(34,623)	4.6359	67% of 3-Month LIBOR* + 0.69%**	A2, A+
Total		**$ 204,995**	**$ (45,758)**			

* 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 in an adverse market 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 $80 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, 2013, no collateral 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, 2013, the accumulated decrease or increase in the fair value of the effective swaps is reported as deferred outflow of resources or as deferred inflow of resources, respectively, in the Statement of Net Position. 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 Position and the Statement of Activities.

Table 38

Schedule of Swap Agreement Fair Value – California Housing Finance Agency
June 30, 2013
(amounts in thousands)

		Amount
Statement of Net Position:		
Other noncurrent assets	$	137
Deferred outflows of resources		126,717
Other noncurrent liabilities		217,718
Statement of Activities:		
Other general revenues (expenses)		(6,124)

Table 29 presents the State's debt service requirements and net swap payments as of June 30, 2013. Included in these amounts are CalHFA's principal, variable interest, and interest-rate net swap payments in the amounts of $1.3 billion, $23 million, and $793 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, 2013, 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 holds eight basis swaps as a means to change the variable-rate formula received from counterparties for the $190 million outstanding notional amount from 65% of LIBOR to varying floating rates.

Terms, Fair Value, and Credit Risk: CalHFA uses 11 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, 2013, CalHFA had total cash and fair value of mortgage-backed securities posted as collateral with swap counterparties of $3 million and $59 million, respectively, in other assets and investments in the Statement of Net Position. As of June 30, 2013, CalHFA's swap portfolio has an aggregate negative fair value of $218 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 88 swap transactions, with outstanding notional amounts of $1.9 billion, with effective dates from April 6, 2000, to November 1, 2009, and scheduled termination dates from August 1, 2014, to August 1, 2042. Standard & Poor's credit ratings for these counterparties range from BBB to AA-; 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, 2013, the SIFMA rate was .06%, the one-month LIBOR was .19%, the three-month LIBOR was .27%, and the six-month LIBOR was .41%.

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.

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, 2013
(amounts in thousands)

	Due To				
Due From	**General Fund**	**Transportation Fund**	**Environmental and Natural Resources Fund**	**Nonmajor Governmental Fund**	**Electric Power Fund**
Governmental funds					
General Fund	$ —	$ 79,304	$ 323,442	$ 775,315	$ —
Federal Fund	361,133	1,047,110	51,140	153,847	—
Transportation Fund	—	—	38,402	45,705	—
Environmental and Natural Resources Fund	—	—	—	99	—
Nonmajor governmental funds	341,939	22,878	18,715	16,156	—
Total governmental funds (Asset)	**703,072**	**1,149,292**	**431,699**	**991,122**	**—**
Enterprise funds					
Water Resources Fund	—	—	—	—	—
Public Buildings Construction Fund	563	—	—	—	—
State Lottery Fund	155	—	—	375,000	—
Unemployment Programs Fund	34,561	—	—	—	—
Nonmajor enterprise funds	2,509	—	156	217	—
Total enterprise funds (Asset)	**37,788**	**—**	**156**	**375,217**	**—**
Internal service funds	**23,845**	**16,517**	**5,327**	**18,667**	**4,000**
Total primary government (Asset)	**$ 764,705**	**$ 1,165,809**	**$ 437,182**	**$ 1,385,006**	**$ 4,000**

Due To								
Water Resources Fund	**Public Buildings Construction Fund**	**State Lottery Fund**	**Unemployment Programs Fund**	**California State University Fund**	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Fiduciary Funds**	**Total (Liability)**
$ —	$ —	$ —	$ —	$ —	$ —	$ 112,743	$ 10,370,360	$ 11,661,164
—	—	—	20,708	—	1,617	44,860	6,658,387	8,338,802
—	283	—	—	—	—	28,240	55,246	167,876
—	—	—	—	—	15	16,539	113	16,766
—	—	—	—	436	148	35,172	1,668,193	2,103,637
—	**283**	**—**	**20,708**	**436**	**1,780**	**237,554**	**18,752,299**	**22,288,245**
—	—	—	—	—	—	49,172	—	49,172
—	—	—	—	—	—	18,488	370	19,421
—	—	—	—	—	—	—	—	375,155
—	—	—	—	—	—	495	—	35,056
—	—	—	—	—	—	41	11	2,934
—	**—**	**—**	**—**	**—**	**—**	**68,196**	**381**	**481,738**
899	**29,851**	**277**	**1,708**	**—**	**552**	**5,139**	**689**	**107,471**
$ 899	**$ 30,134**	**$ 277**	**$ 22,416**	**$ 436**	**$ 2,332**	**$ 310,889**	**$ 18,753,369**	**$ 22,877,454**

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, Environmental and Natural Resources Funds, and nonmajor governmental funds—to the General Fund. The $3.6 billion in Transportation Fund loans payable from the General Fund also includes $1.1 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, 2013
(amounts in thousands)

	Interfund Payables			
Interfund Receivables	**General Fund**	**Transportation Fund**	**Environmental and Natural Resources Fund**	**Nonmajor Governmental Funds**
Governmental funds				
General Fund	$ —	$ 3,606,097	$ 535,477	$ 1,668,798
Transportation Fund	—	—	—	—
Environmental and Natural Resources Fund	7,000	3,979	—	—
Nonmajor governmental funds	6,117	—	—	—
Total governmental funds	**13,117**	**3,610,076**	**535,477**	**1,668,798**
Internal service funds	**40,650**	**—**	**—**	**172**
Total primary government	**$ 53,767**	**$ 3,610,076**	**$ 535,477**	**$ 1,668,970**

Interfund Payables				
Water Resources Fund	Unemployment Programs Fund	Nonmajor Enterprise Funds	Internal Service Funds	Total
$ —	$ 611,690	$ 5,600	$ 7,384	$ 6,435,046
—	—	—	2,648	2,648
—	—	—	—	10,979
—	—	—	—	6,117
—	**611,690**	**5,600**	**10,032**	**6,454,790**
91,517	**—**	**—**	**6,943**	**139,282**
$ 91,517	**$ 611,690**	**$ 5,600**	**$ 16,975**	**$ 6,594,072**

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, 2013
(amounts in thousands)

	Due To Component Units		
Due From	**University of California**	**Nonmajor Component Units**	**Total**
Governmental funds			
General Fund	$ 169,215	$ —	$ 169,215
Transportation Fund	909	—	909
Environmental and Natural Resources Fund	2,000	11	2,011
Nonmajor governmental funds	36,988	—	36,988
Total governmental funds	**209,112**	**11**	**209,123**
Internal service funds	**—**	**2**	**2**
Total primary government	**$ 209,112**	**$ 13**	**$ 209,125**

B. Interfund Transfers

Transfers move money collected by one fund to another fund, which then disburses it as required by law. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfer from the General Fund was $2.0 billion to California State University (a major enterprise fund). The State Highway Account transferred $678 million of weight fee revenues to the Transportation Debt Service Fund for reimbursement of debt service costs. The Federal Fund transferred $640 million to the General Fund for administration of the Unemployment Insurance Program.

Table 42 presents interfund transfers of the primary government.

Table 42

Schedule of Interfund Transfers
June 30, 2013
(amounts in thousands)

	Transferred To		
Transferred From	**General Fund**	**Transportation Fund**	**Environmental and Natural Resources Funds**
Governmental funds			
General Fund	$ —	$ —	$ 853
Federal Fund	640,445	—	150,415
Transportation Fund	69,136	—	10,909
Environmental and Natural Resources Fund	11,210	3,979	—
Nonmajor governmental funds	254,297	16	25,246
Total governmental funds	**975,088**	**3,995**	**187,423**
Public Buildings Construction Fund	**8,172**	—	—
California State Univeristy Fund	—	—	—
Nonmajor enterprise funds	**11,584**	—	—
Internal service funds	**16,413**	—	—
Total primary government	**$ 1,011,257**	**$ 3,995**	**$ 187,423**

Transferred To				
Nonmajor Governmental Funds	Public Buildings Construction Fund	California State University Fund	Internal Service Funds	Total
$ 855,543	$ —	$ 2,034,055	$ —	$ 2,890,451
30,108	—	—	—	820,968
717,356	—	—	—	797,401
16,794	—	—	—	31,983
78,391	—	—	—	357,950
1,698,192	**—**	**2,034,055**	**—**	**4,898,753**
—	**—**	**—**	**—**	**8,172**
16,540	**—**	**—**	**—**	**16,540**
—	**202**	**—**	**—**	**11,786**
40,354	**—**	**—**	**4,730**	**61,497**
$ 1,755,086	**$ 202**	**$ 2,034,055**	**$ 4,730**	**$ 4,996,748**

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, 2013
(amounts in thousands)

	General Fund	Federal Fund	Transportation Fund	Environmental and Natural Resources Fund	Nonmajor Governmental Funds
Nonspendable					
Long-term interfund receivables	$ 53,767	$ —	$ —	$ —	$ —
Long-term loans receivable	86,340	—	—	—	—
Other	—	—	—	—	15,022
Total nonspendable	**140,107**	**—**	**—**	**—**	**15,022**
Restricted					
General government	5,835	—	—	12,477	3,708,845
Education	79,303	296	4,784	—	833,151
Health and human services	87,381	257	—	1,198,829	1,563,980
Resources	247	10,809	—	5,648,940	77,368
State and consumer services	5,877	—	220,829	57,542	524,217
Business and transportation	—	186,591	6,965,234	44,310	3,075,709
Correctional programs	—	—	—	—	3,102
Total restricted	**178,643**	**197,953**	**7,190,847**	**6,962,098**	**9,786,372**
Committed					
General government	13,616	—	—	25,749	260,580
Education	1,301	—	—	—	34,728
Health and human services	7,962	—	1,926	—	236,333
Resources	—	—	13	819,971	729,645
State and consumer services	—	—	—	17,928	52,359
Business and transportation	—	—	47,471	—	76,380
Correctional programs	—	—	—	—	14,952
Total committed	**22,879**	**—**	**49,410**	**863,648**	**1,404,977**
Assigned – General government	—	—	—	—	209,171
Unassigned	**(14,596,085)**	**—**	**(9,560)**	**(7,870)**	**(158,636)**
Total fund balances (deficit)	**$ (14,254,456)**	**$ 197,953**	**$ 7,230,697**	**$ 7,817,876**	**$ 11,256,906**

B. Fund Deficits

Table 44 shows the funds that had deficits.

Table 44

Schedule of Fund Deficits
June 30, 2013
(amounts in thousands)

	Governmental Funds	Enterprise Funds
General Fund	$ 14,254,456	$ —
Unemployment Programs Fund	—	4,151,745
Total fund deficits	**$ 14,254,456**	**$ 4,151,745**

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 position categories of the government-wide and fund financial statements. As of June 30, 2013, the total value of restricted endowments and gifts was $12.1 billion and unrestricted endowments and gifts was $1.6 billion. The University's policy is to retain realized and unrealized 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 $1.7 billion at June 30, 2013. 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 $867 million and $7 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 $3.5 billion as of June 30, 2013. 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 $5.0 billion is discounted to $3.5 billion using a 3.5% interest rate. Of the total, $414 million is a current liability, of which $270 million is included in the General Fund, $141 million in the special revenue funds, and $3 million in the internal service funds. The remaining $3.1 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Position.

The University of California, a discretely presented component unit, is self-insured or insured through a wholly-owned captive insurance company 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% to 5%.

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 Unit University of California	
	2013	**2012**	**2013**	**2012**
Unpaid claims, beginning	$ 3,204,635 *	$ 3,031,926 *	$ 599,176	$ 589,076
Incurred claims	754,641	554,701 *	421,832	347,331
Claim payments	(449,721)	(381,992) *	(389,210)	(337,231)
Unpaid claims, ending	**$ 3,509,555**	**$ 3,204,635 ***	**$ 631,798**	**$ 599,176**

* Restated

NOTE 21: DEFERRED OUTFLOWS OF RESOURCES AND DEFERRED INFLOWS OF RESOURCES INCLUDING SERVICE CONCESSION ARRANGEMENTS

The GASB identified transactions relating to deferred outflows of resources and deferred inflows of resources through GASB Statement Nos. 53, 60, 63 and 65. The State of California early implemented GASB Statement No. 65 (GASB 65), *Items Previously Reported as Assets and Liabilities*, for the fiscal year beginning July 1, 2012.

The following discretely presented component units also early implemented GASB 65: California Infrastructure and Economic Development Bank, and California State University Auxiliary Organizations.

Certain transactions that were previously reported as assets and liabilities are now reclassified as deferred outflows of resources and deferred inflows of resources pursuant to GASB 65.

1. Deferred Outflows of Resources

The State of California's deferred outflows of resources consist of the following transactions:

- Loss on Refunding of Debt – Refunding of some previously outstanding general obligation bonds and revenue bonds resulted in losses for governmental activities, business-type activities and component units for the fiscal year 2012-13. These losses reported as deferred outflows of resources will be recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

- Derivative Instrument – Negative changes in the fair value of hedging derivatives are reported as deferred outflows of resources. The business-type activities and component units reported decreases in fair value of hedging derivatives.

2. Deferred Inflows of Resources

The State of California's deferred inflows of resources consist of the following transactions:

- Service Concession Arrangements – The State and its component units have entered into service concession arrangements with third parties for park facility services, student housing, and certain other services. For the fiscal year 2012-13, the primary government and component units reported deferred inflow of resources from service concession arrangements.

  GASB Statement No. 60 (GASB 60), *Accounting and Financial Reporting for Service Concessions Arrangements,* is effective beginning July 1, 2012, for the State's fiscal reporting period. A service concession arrangement is an arrangement between a transferor (State) and an operator (State or non-governmental entity), where rights and obligations to provide services through the use of public assets are transferred to an operator by the transferor, in exchange for significant consideration, and the operator is compensated by fees collected from third parties. GASB requires retrospective application of GASB 60 for all periods presented.

  The State entered into various service concessions arrangements with independent third parties to develop, equip, operate, and maintain nonexclusive concessions at park grounds in exchange for fixed installment payments, for a fixed period of time. These third parties are compensated by user fees. These existing facilities are reported as capital assets by the State, the present value of installment payments are reported as receivables and a corresponding deferred inflow of resources is reported in the government-wide Statement of Net Position. The State reserves the right to provide or modify the types of goods and services provided by the operator to ensure that the public receives fair pricing, proper service and appropriate quality. The State is not obligated by the debts of the operator in the event of a default, nor does the State guarantee minimum revenue to the operator.

University of California, reported as a discretely presented component unit, has entered into service concession arrangements with third parties for student housing and certain other faculty and student services. Under these arrangements, the University enters into ground leases with third parties at minimal or no cost, and gives the third party the right to construct, operate, and maintain a facility, primarily for the benefit of students and faculty, at competitive rates. Rate increases for use of the facilities are subject to certain constraints, and ownership of the facilities reverts to the University upon expiration of the ground lease. The facilities are reported as capital assets by the University when placed in service, and a corresponding deferred inflow of resources is reported. The University has not provided guarantees on financing obtained by the third parties under these arrangements.

- Gain from Refunding of Debt – Refunding of some previously outstanding general obligation bonds and revenue bonds resulted in gains for governmental activities and discretely presented component units for the fiscal year 2012-13. These gains reported as deferred inflows of resources will be recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter

- Other Deferred Inflows of Resources – Revenues generated from current rates from regulated business-type activities intended to recover costs that are expected to be incurred in the future.

In the fund financial statements, governmental funds reported deferred inflows of resources of $1.9 billion because this amount represents revenues that will be collected after year end, but are not available soon enough to pay for the current period expenditures. For deferred outflows and inflows of resources at the government-wide level, see table below.

Table 46

Schedule of Deferred Inflows of Resources and Deferred Outflows of Resources

(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
Deferred Outflows of Resources:				
Deferred loss on refundings	911,178	478,308	$ 1,389,486	$ 5,071
Decrease in fair value of hedging derivatives	—	2,000	2,000	172,475
Total Deferred Outflows of Resources	**911,178**	**480,308**	**1,391,486**	**177,546**
Deferred Inflows of Resources:				
Deferred gain on refundings	(86,135)	—	(86,135)	(2,481)
Service concession arrangements	(72,807)	—	(72,807)	(31,575)
Other deferred inflows	—	(471,436)	(471,436)	—
Total Deferred Inflows of Resources	**$ (158,942)**	**$ (471,436)**	**$ (630,378)**	**$ (34,056)**

NOTE 22: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as the promotion of renewable energy sources and financing for economic development projects. 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, 2013, these component units had $4.2 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 $320 million, which is not debt of the State. CalHFA reported offsetting assets and liabilities related to these obligations. The net impact on net position 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, 2013; legal proceedings that were in progress as of June 30, 2013, and were settled or decided against the primary government as of April 16, 2014; and legal proceedings having a high probability of resulting in a decision against the primary government as of April 16, 2014, 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 the Bakersfield case, 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 (approximately $500 million) in these cases, should they prevail.

The primary government is a defendant in two cases, *Harley-Davidson, Inc. and Subsidiaries v. Franchise Tax Board* and *Abercrombie & Fitch Co. & Subsidiaries v. Franchise Tax Board,* both regarding the constitutionality of Revenue and Taxation code section 25101.15 allowing intrastate unitary businesses the option of reporting the income of various entities within the unitary business on either a separate or combined basis. Both plaintiffs claim, among other things, that section 25101.15 is discriminatory and they should be allowed to report the income of their business entities on a separate basis. The State is vigorously defending the constitutionality of section 25101.15. In Harley-Davidson, the Franchise Tax Board successfully demurred to the cause of action alleging that section 25101.15 was unconstitutionally discriminatory. Judgment on the entire case has been granted in favor of the board and the taxpayers have appealed. In Abercrombie, a trial has been set in February of 2015. If the plaintiffs prevail, the State would refund Harley-Davidson approximately $2 million plus interest and Abercrombie approximately $182 thousand plus interest from the General Fund. In addition, if the courts determine that section 25101.15 is unconstitutionally discriminatory, the potential total refunds to other taxpayers are unknown but could be substantial. The potential loss of future revenue, unless the Legislature were to act to address the alleged constitutional violation, would be even more substantial, as such a ruling could significantly diminish the State's ability to tax income apportionable to California under existing law.

The primary government is defendant in six cases, *Kimberly-Clark Worldwide, Inc. et al. v. Franchise Tax Board, Gillette Company v. Franchise Tax Board, Proctor & Gamble v. Franchise Tax Board, Sigma-Aldrich*, *Inc. v. Franchise Tax Board, RB Holdings (USA), Inc. v. Franchise Tax Board,* and *Jones Apparel Group Inc. v. Franchise Tax Board*, regarding the application of California's double-weighted sales factor apportionment formula under Revenue and Taxation Code section 25128. Plaintiffs contend that the single-weighted sales factor apportionment specified in Section 25128 prior to amendment was contained within the Multistate Tax Compact (Compact) and therefore cannot be modified without repealing the legislation that enacted the Compact. The State contends that California properly amended section 25128 to its understanding of the Compact. The parties have completed briefing in the California Supreme Court and await a hearing date. The total amount of tax refunds at issue in these six cases is approximately $40 million. An adverse ruling in these cases would affect multiple taxpayers and create potential exposure to refund claims in excess of $750 million.

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 five cases still pending. Neither the outcome nor the estimated potential loss for the remaining cases can be determined at this time.

The primary government is the defendant in a case, *Santa Clarita Valley Sanitation District of LA County (the District) v. Commission on State Mandates*, regarding a 2008 resolution by the Regional Water Quality Control Board for the Los Angeles Region (the Board) that imposed limits on chloride concentrations in water processed by the District's two water reclamation plants. The District alleges that the resolution created a reimbursable state mandate under Government Code section 17514 and article XII B, section 6, of the California Constitution. The District challenged the Board's resolution in a test claim before the California Commission on State Mandates (the Commission). In a January 31, 2014 decision, the Commission ruled the Board's resolution did not constitute a reimbursable state-mandated program under the California Constitution or Government

Code. The District filed a petition for administrative mandate seeking review of the Commission's decision. The estimated potential loss is about $6.5 million for costs incurred by petitioners to date and about $250 million in increased expenditures. Since this case is a test claim, other districts could also bring claims for reimbursement under the same theory.

The primary government is a party to the *Washington Mutual, Inc., et al. United States Bankruptcy Court* case. The case involves the propriety of tax refund claims submitted by Washington Mutual and its affiliates for multiple tax years through 2008. The underlying dispute centers on the taxpayer's claims of tax benefits arising from its use of certain net operating losses, Registered Investment Companies, Real Estate Investment Trusts, etc. A settlement agreement in the case is pending. The estimated potential loss is $223.5 million.

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.

The California Legislature passed and the Governor signed the "Public Employees' Pension Reform Act of 2013" (PEPRA) on September 12, 2012. PEPRA contained a number of provisions intended to reduce future pension obligations. PEPRA primarily affects new pension plan members who are enrolled for the first time after December 31, 2012. The financial impact will be gradually realized as total pension costs and the employer share of those costs decrease.

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 Plan, 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 94229-2703 or by visiting the CalPERS website at www.CalPERS.ca.gov.

CalPERS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are earned. Employer contributions are recorded when earned and the employer has made a formal commitment to provide the contributions. Benefits and refunds in the defined benefit plans 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, the Defined Benefit Supplement Program, the Cash Balance Benefit Program, and the Replacement Benefit 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 95851-0275 or by visiting the CalSTRS website at www.CalSTRS.com.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are earned. Employer and primary government contributions are recognized when earned 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 and cost-sharing defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,520 public agencies as of June 30, 2013.

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 $57.4 billion at June 30, 2012, as a result of the difference between the actuarial value of assets of $283.0 billion and the actuarial accrued liability of $340.4 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 act as a common investment and administrative agent of the primary government and the other member agencies. 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, 2012 actuarial valuation, the payroll for primary government employees covered by the PERF for the 2011-12 fiscal year was $15.7 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 formulas. 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, 2013

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	8.370 %	12.057 %	0.076 %	20.503 %
Second tier	8.324	12.057	0.076	20.457
Industrial (first and second tier)	11.220	5.082	0.000	16.302
California Highway Patrol	14.162	19.540	0.026	33.728
Peace officers and firefighters	16.458	13.813	0.026	30.297
Other safety members	12.740	4.738	0.025	17.503

For the year ended June 30, 2013, the annual pension cost (APC) and the amount of contributions made by the primary government were each $3.2 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, 2012, 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.

B. Teachers' Retirement Fund

Plan Description: CalSTRS administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to finance 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, 2013, the DB Program had 1,659 contributing employers and as of June 30, 2012, had 421,499 active and 178,655 inactive program members and 262,038 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, 2013, 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 amount of funds contributed. Vesting in the DBS Program occurs automatically with vesting in the DB Program. 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 or the election period determined by the employer. At June 30, 2013, the CB Benefit Program had 31 contributing school districts and 33,710 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 Section 415(m). Internal Revenue Code 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 Internal Revenue Code Section 415(b), subject to withholding for any applicable income or employment taxes. At June 30, 2013, the RB Program had 267 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, under the CalSTRS 2% at 60, contribution rate for members is 8.00% of creditable compensation, while under the CalSTRS 2% at 62, the contribution rate for members is 50% of the normal cost of their retirement plan, which resulted in an 8.00% contribution rate of creditable compensation for the fiscal year 2012-13. The employer contribution rate is 8.25% of creditable compensation. In fiscal year 2012-13, 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 actuarial 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 actuarial 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. Based on the most recent actuarial valuation, as of June 30, 2012, 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 1.024% starting October 1, 2013.

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, 2013, the APC for the DB Program was approximately $6.6 billion; the employer and primary government contributions were approximately $2.2 billion and $733 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.

Table 48

Actuarial Information – Pension Trusts – Public Employees' Retirement Fund and State Teachers' Retirement Defined Benefit Program Fund

Valuation Date As Indicated

	Public Employees' Retirement Fund		State Teachers' Retirement Defined Benefit Program Fund [1]	
Last actuarial valuation	June 30, 2012		June 30, 2012	
Actuarial cost method	Individual Entry Age Normal		Entry Age Normal	
Amortization method	Level % of Payroll, Closed		Level % of Payroll, Open	
Remaining amortization period	18 - 23 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 6/30/11	$ 3,277		$ 5,985	
Year ended 6/30/12	2,928		6,230	
Year ended 6/30/13	3,236		6,629	
Percent contribution				
Year ended 6/30/11	100	%	47	%
Year ended 6/30/12	100		46	
Year ended 6/30/13	100		44	
Funding as of last valuation (in millions)				
Actuarial value – assets	$ 106,145		$ 144,232	
Actuarial accrued liabilities (AAL) – entry age	134,314		214,765	
Unfunded actuarial accrued liability (UAAL)	28,169		70,533	
Covered payroll	15,680		26,404	
Funded ratio	79.0	%	67.2	%
UAAL as percent of covered payroll	179.6	%	267.1	%

[1] 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 Teacher's Retirement Law, and the related Education Codes, the State and local government employers contributed $733 million and $2.2 billion, respectively, for the year ending June 30, 2013. Based on the most recent actuarial valuation, dated June 30, 2012, 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

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 0.25% 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 a self-funded 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.

Fifty-eight county superior courts (trial courts) are included in the primary government. However, each trial court is a separate employer for GASB Statement No. 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.

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 2012-13 fiscal year, approximately 163,100 annuitants were enrolled to receive health benefits and approximately 135,100 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 2013 monthly State contribution was $622 for one-party coverage, $1,183 for two-party coverage, and $1,515 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 No. 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 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, 2013, the State contributed $1.8 billion toward annuitants' health and dental benefits. Of this amount, the trial courts represent $33 million and certain discretely presented component units represent $5 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, 2013, 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)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2011	$ 4,359,929	36.70 %	$ 10,357,406
June 30, 2012	4,837,769	36.20	13,440,768
June 30, 2013	4,992,924	35.33	16,267,964

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, 2013
(amounts in thousands)

	Amount
Annual required contribution	$ 4,925,460
Interest on net OPEB obligation	586,532
Adjustment to annual required contribution	(519,068)
Annual OPEB cost	**4,992,924**
Contributions made	(1,763,872)
Increase in net OPEB obligation	3,229,052
Net OPEB obligation – beginning of year	**13,038,912** *
Net OPEB obligation – end of year	**$ 16,267,964**

* Beginning balance restated by $402 million due to elimination of discretely presented component units (GASB 61).

Funded Status and Funding Progress: As of June 30, 2013—the most recent actuarial valuation date for the State substantive plan—the actuarial accrued liability (AAL) for benefits was $64.6 billion, and the actuarial value of assets was $10 million, resulting in an unfunded actuarial accrued liability (UAAL) of $64.6 billion. The covered payroll (annual payroll of active employees covered by the plan) was $18.1 billion, and the ratio of the UAAL to the covered payroll was 358%.

For the trial courts, as of July 1, 2011—the most recent actuarial valuation date—the AAL for benefits was $1.4 billion and the actuarial value of assets was $17 million, resulting in an UAAL of $1.4 billion. The covered payroll was $922 million and the ratio of the UAAL to covered payroll was 148%.

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, 2013 State substantive plan actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 4.25% investment rate of return and an annual health care cost trend rate of actual increases for 2014 and 8.50% in 2015, initially, reduced to an ultimate rate of 4.50% after six years. Both rates included a 2.75% annual inflation assumption. Annual wage inflation is assumed to be 3.00%. 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.

The University of California (University) is the employer providing OPEB benefits through its Retirement Health Plan to its eligible retirees and their families. As the University is the employer providing these benefits, the State will not be reporting these benefits in Note 25 or the Required Supplementary Information. Information regarding the University and references to its financial statements can be found in Note 1, Section A-3.

NOTE 26: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2013, but prior to the date of the auditor's report.

A. Debt Issuances

Between September 2013 and March 2014, the primary government issued $5.2 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; kindergarten-university public education facilities; and stem cell research.

In August 2013, the California State University (CSU) issued $309 million in revenue bonds to refund outstanding Systemwide Revenue Bonds Series 2005A and 2005C and other outstanding bond indebtedness by an auxiliary organization. Between July and September 2013, the CSU issued a combined total of $79 million in Bond Anticipation Notes (BANs) for the Student Health & Counseling Center at the San Jose campus and for student housing at the Bakersfield, Northridge, and San Diego campuses.

In August 2013, the Regents of the University of California, a discretely presented component unit, issued $650 million in revenue bonds to finance the East Campus Bed Tower project at UC San Diego Medical Center as well as other projects at UC Irvine Medical Center, UC Davis Medical Center and UCLA Medical Center. In October 2013, the Regents issued $2.5 billion in general revenue bonds to refinance the acquisition and construction of University facilities through the refunding of the outstanding Lease Revenue Bonds issued by the State Public Works Board of the State of California on behalf of the University. In April 2014, the Regents issued $970 million in general revenue bonds to finance or refinance the acquisition and construction of University facilities.

Between October 2013 and April 2014, the State Public Works Board issued a combined total of $1.9 billion in lease revenue bonds to finance and refinance the cost of design and/or construction of various projects for the benefit of the Department of Corrections and Rehabilitation, California State University, Department of Food and Agriculture, and Judicial Council of California.

In March 2014, the Department of Water Resources issued $161 million in water system revenue bonds to fund construction of certain Water System Projects, to refund outstanding water revenue commercial paper notes, to fund a deposit to the Debt Service Reserve Account, to fund interest on a portion of the bonds, and to pay the related issuance costs.

On September 1, 2013, the Department of Veterans Affairs voluntarily redeemed $44 million of general obligation bonds.

B. Cash Management

In August 2013, the State issued $5.5 billion of Revenue Anticipation Notes to fund the State's cash management needs for the 2013-14 fiscal year and to support the cash flow needs of the General Fund.

C. Other

In October 2013, the Governor signed into law Senate Bill No. 13. This legislation amends the Public Employees' Pension Reform Act of 2013 (PEPRA) correcting or clarifying several provisions including those related to new judges' retirement benefits. Key provisions of this legislation include requiring that new judges be subject to an employee contribution rate of at least 50% of the normal cost, and it corrected a requirement that new judges are not subject to the PEPRA retirement formulas. This law also provides clarification about accumulated additional contributions being used to calculate one of the benefit options for CalPERS safety members eligible for the industrial disability retirement benefits and who retire on or after January 1, 2013.

As of September 30, 2013, the cities of San Bernardino and Stockton are still seeking financial relief under Chapter 9 of the Federal Bankruptcy Code having filed for relief in the prior year, while the city of Mammoth Lakes has resolved its bankruptcy issues. The two local governments provide retirement benefits through CalPERS. One of the two cities met its pension obligations and remitted annual contributions during fiscal year 2012-13, while the other ceased paying its annual contributions for a period of time during the year and was approximately $14 million in arrears as of June 30, 2013. These local governments have yet to obtain confirmation of their final bankruptcy plans, and therefore, the outcome and the impact of the bankruptcy proceedings, at these stages of the cases, are unknown.

California's demand for unemployment insurance benefits required additional loans from the U.S. Department of Labor during the 2013-14 fiscal year. As of June 30, 2013, the State had $8.6 billion in outstanding loans from the U.S. Department of Labor which were used to cover deficits in the Unemployment Programs Fund. As of April 16, 2014, the State had an outstanding loan balance of $10.1 billion, and it expects to request additional loans throughout 2014.

In August 2013, Fitch Ratings raised its rating on the State's general obligation bonds to "A" from "A-" citing the State's institutional changes to fiscal management and its ongoing economic and revenue recovery. Fitch Ratings also raised its rating on State Public Works Board bonds to "A-" from "BBB+".

In November 2013, December 2013, and February 2014, the primary government substituted or extended the letters of credit for certain series of variable rate general obligation bonds and commercial paper notes to take advantage of lower letter of credit commitment fees. As a result of the letter of credit substitution or extension, new letter of credit and reimbursement agreements were entered into with expiration dates in 2016 and 2017. Also due to the substitution, Moody, Standard & Poor's Rating Services, and Fitch Rating raised ratings on various bond series and Fitch lowered its rating on other bonds.

In December 2013 and February 2014, the primary government removed one and added two letter of credit bank facilities to the commercial paper program, and new letter of credit and reimbursement agreements were entered into with expiration dates in 2016 and 2017. The commercial paper lines had a net increase from $1.6 billion to $1.7 billion.

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, 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
June 30, 2012	106,145	134,314	28,169	79.0	15,680	179.6

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, 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
June 30, 2012	144,232	214,765	70,533	67.2	26,404	267.1

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)
State substantive plan						
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
June 30, 2013	10	64,584	64,574	0.0	18,060	357.6
Trial Courts [1]						
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	922	148.4

[1] The trial courts reporting is based on 49 individual biennial actuarial valuations as of July 1, 2011.

Note: The University of California (UC) is the employer providing OPEB benefits through its Retirement Health and Welfare Plans to its eligible retirees and their families. As UC is the employer providing these benefits, the State will not be reporting these benefits in Note 25 or the Required Supplementary Information. Information regarding the University of California and references to their financial statements can be found in Note 1, Section A-3.

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, 2013, are in the following categories and amounts: state highway infrastructure (completed highway projects) totaling $63.4 billion, land purchased for highway projects totaling $12.8 billion, and infrastructure construction-in-progress (uncompleted highway projects) totaling $8.3 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, 2013, donations are $6 million of infrastructure land, and relinquishments are $66 million of state highway infrastructure and $13 million of infrastructure land, respectively.

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' "Guide to Commonly Recognized Structural Elements."

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 2010-11 through 2012-13 are shown in the following table:

Fiscal Year Ending June 30	**Established BHI Baseline***	**Actual BHI**
2011	80.0	94.3
2012	80.0	94.5
2013	80.0	94.8

* 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, 2013:

BHI Description	**Bridge Count**	**Percent**	**Network BHI**
Excellent	6,952	53.19 %	99.9
Good	4,716	36.08	96.6
Acceptable	760	5.81	85.4
Fair	156	1.19	73.6
Poor	116	0.89	66.2
Does not carry traffic	371	2.84	93.1
Total	**13,071**	**100.00 %**	

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:

Condition Assessment Date [1]	**Established Condition Baseline Distressed Lane Miles (maximum)** [2]	**Actual Distressed Lane Miles**	**Actual Distressed Lane Miles as Percent of Total Lane Miles**
March 2008	18,000	12,998	26.3 %
December 2011 [3]	18,000	12,333	24.9
December 2013	18,000	7,820	15.7

[1] 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.

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

[3] 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.

Pavement Condition	**Lane Miles**	**Distressed Lane Miles**
Excellent/Good	41,898	—
Fair	2,483	2,483
Poor	5,337	5,337
Total	49,718	7,820

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.

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

Fiscal Year Ending June 30	**Estimated Budgeted Preservation Costs (in millions)**	**Actual Preservation Costs (in millions)**
2009	$ 2,910	$ 1,821
2010	2,162	694
2011	2,802	1,358
2012	2,722	1,504
2013	1,598	375

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2013
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ 7,580,000	$ 7,509,000	$ 7,459,443	$ (49,557)
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	91,000	91,000	90,005	(995)
Inheritance, estate, and gift taxes	45,000	—	—	—
Insurance gross premiums tax	2,022,000	2,156,000	2,221,317	65,317
Vehicle license fees	25,718	28,718	26,445	(2,273)
Motor vehicle fuel tax	—	—	—	—
Personal income tax	60,647,000	63,901,000	65,443,286	1,542,286
Retail sales and use taxes	20,714,000	20,240,000	20,414,799	174,799
Other major taxes and licenses	321,200	326,200	357,632	31,432
Other revenues	2,148,454	2,195,082	2,404,834	209,752
Total revenues	**93,594,372**	**96,447,000**	**98,417,761**	**1,970,761**
EXPENDITURES				
State and consumer services	1,335,204	681,611	661,143	20,468
Business and transportation	90,476	90,456	90,407	49
Resources	940,947	1,177,395	1,161,104	16,291
Health and human services	26,658,419	27,395,474	26,999,956	395,518
Correctional programs	8,820,897	8,700,193	8,500,608	199,585
Education	50,127,515	48,787,555	48,686,126	101,429
General government:				
Tax relief	438,852	438,852	427,285	11,567
Debt service	4,435,522	4,438,663	4,394,324	44,339
Other general government	4,786,351	5,204,292	4,987,016	217,276
Total expenditures	**97,634,183**	**96,914,491**	**95,907,969**	**1,006,522**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	2,047,256	—
Transfers to other funds	—	—	(344,599)	—
Other additions and deductions	—	—	1,681,288	—
Total other financing sources (uses)	—	—	**3,383,945**	—
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses	—	—	5,893,737	—
Fund balances - beginning	—	—	**(1,608,600)**	—
Fund balances - ending	**$ —**	**$ —**	**$ 4,285,137**	**$ —**

Federal				**Transportation**			
Budgeted Amounts		**Actual**	**Variance With**	**Budgeted Amounts**		**Actual**	**Variance With**
Original	**Final**	**Amounts**	**Final Budget**	**Original**	**Final**	**Amounts**	**Final Budget**
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
55,499,998	55,499,998	55,499,998	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	5,545,016	5,618,575	5,492,850	(125,725)
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,724,808	3,705,494	3,735,168	29,674
32	32	32	—	380,656	426,382	370,121	(56,261)
55,500,030	**55,500,030**	**55,500,030**	—	**9,650,480**	**9,750,451**	**9,598,139**	**(152,312)**
35,434	35,434	35,434	—	111,168	109,814	97,820	11,994
3,556,096	3,556,096	3,556,096	—	10,929,923	10,888,601	9,165,455	1,723,147
363,775	363,775	363,775	—	156,155	154,388	151,482	2,906
41,078,078	41,078,078	41,078,078	—	3,365	3,323	2,846	476
80,364	80,364	80,364	—	—	—	—	—
6,964,294	6,964,294	6,964,294	—	980	2,587	2,467	120
—	—	—	—	2,103	2,103	2,103	—
—	—	—	—	2,408	2,886	1,441	1,445
702,040	702,040	702,040	—	487,274	516,898	498,131	18,767
52,780,081	**52,780,081**	**52,780,081**	—	**11,693,376**	**11,680,600**	**9,921,745**	**1,758,855**
—	—	12,583,101	—	—	—	14,455,171	—
—	—	(15,280,390)	—	—	—	(16,264,844)	—
—	—	(22,628)	—	—	—	(1,114,596)	—
—	—	**(2,719,917)**	—	—	—	**(2,924,269)**	—
—	—	32	—	—	—	(3,247,875)	—
—	—	**10,737**	—	—	—	**25,690,829**	—
$ —	**$ —**	**$ 10,769**	**$ —**	**$ —**	**$ —**	**$ 22,442,954**	**$ —**

(continued)

Budgetary Comparison Schedule (continued)

General Fund and Major Special Revenue Funds

Year Ended June 30, 2013
(amounts in thousands)

	Environmental and Natural Resources			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
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	148,326	148,326	148,326	—
Other revenues	3,175,948	3,175,948	3,175,948	—
Total revenues	**3,324,274**	**3,324,274**	**3,324,274**	—
EXPENDITURES				
State and consumer services	83,374	83,216	67,297	15,919
Business and transportation	5,668	5,666	5,666	—
Resources	4,494,202	4,502,774	3,761,481	741,293
Health and human services	220,228	219,550	115,043	104,507
Correctional programs	—	—	—	—
Education	8,166	8,165	8,025	140
General government:				
Tax relief	—	—	—	—
Debt service	—	—	—	—
Other general government	95,621	97,358	84,575	12,783
Total expenditures	**4,907,259**	**4,916,729**	**4,042,087**	**874,642**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	483,438	—
Transfers to other funds	—	—	(380,327)	—
Other additions and deductions	—	—	160,218	—
Total other financing sources (uses)	—	—	**263,329**	—
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses	—	—	(454,484)	—
Fund balances - beginning	—	—	**12,479,726**	—
Fund balances - ending	**$** —	**$** —	**$ 12,025,242**	**$** —

(concluded)

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

June 30, 2013
(amounts in thousands)

		Special Revenue Funds		
	General	**Federal**	**Transportation**	**Environmental and Natural Resources**
Budgetary fund balance reclassified into GAAP statement fund structure	**$ 4,285,137**	**$ 10,769**	**$ 22,442,954**	**$ 12,025,242**
Basis difference:				
Interfund receivables	53,767	—	3,610,076	535,477
Loans receivable	165,643	186,236	—	1,023,710
Interfund payables	(6,435,046)	—	(2,648)	(10,979)
Escheat property	(905,203)	—	—	—
Bonds authorized but unissued	—	—	(17,805,340)	(5,905,460)
Tax revenues	283,600	—	—	—
GASB 54 classification changes	85,562	1,738	—	—
Other	6,075	—	(839,405)	156,953
Timing difference:				
Liabilities budgeted in subsequent years	(11,793,991)	(790)	(174,940)	(7,067)
GAAP fund balance (deficit), June 30, 2013	**$ (14,254,456)**	**$ 197,953**	**$ 7,230,697**	**$ 7,817,876**

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 balances on the budgetary basis are calculated using 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 $54 million increase to the fund balance in the General Fund, a $3.6 billion increase to the fund balance in the Transportation Fund, and a $535 million increase to the fund balance in Environmental and Natural Resources Fund. The adjustments related to loans receivable caused increases of $166 million in the General Fund, $186 million in the Federal Fund, and $1.0 billion 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 $6.4 billion decrease to the budgetary fund balance in the General Fund, $3 million decrease to the Transportation Fund, and $11 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 $905 million 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 $17.8 billion decrease to the fund balance in the Transportation Fund and a $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 increase of $284 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 Statement No. 54 can be found in Note 1, Summary of Significant Accounting Policies, Section K. These reclassifications caused fund balance increases of $86 million in the General Fund and $2 million in the Federal Fund. The $86 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 $6 million in the General Fund, a fund balance decrease of $839 million in the Transportation Fund, and a $157 million increase 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 $11.7 billion in the General Fund, $790 thousand in the Federal Fund, $175 million in the Transportation Fund, and $7 million in the Environmental and Natural Resources Fund. The large decrease in the General Fund primarily consists of $4.2 billion for deferred apportionment payments to K-12 schools and community colleges, $2.7 billion for medical assistance, $2.2 billion in tax overpayments, $732 million for June 2013 payroll that was deferred to July 2013, and $431 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

ELAINE M. HOWLE, CPA
State Auditor

Date: April 21, 2014

Deputy: John F. Collins II, CPA

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

Team Leads:
Nasir Ahmadi, CPA
Sally Arizaga
Mary Camacho, CPA
Angela Dickison, CPA
Tim Jones
Nicholas Kolitsos, CPA, MBA
Joseph R. Meyer, CPA
Dan Motta, CPA

Staff:
Reed Adam
Laurence Ardi
Keith Auyang
Lisa Ayrapetyan, CIA, CFE
Kelly Chen
Vivian Chu
Brandon A. Clift, CFE
John Dickey, CPA
Brian Dunn
Andrew Esterson
Matt Gannon
Carol Hand
Kevin Henry, MBA
Nathaniel Jones
Veronica Kaufman
Tina Kobler
Martin T. Lee, CPA
Richard Marsh, MST
Gregory D. Martin
Patrick B. McCasland, CPA
Michelle O'Connor, CPA
April Ramos, CPA
Sandra Relat, CPA

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.

Part Two

State of California Internal Control and State and Federal Compliance Audit Report for the Year Ended June 30, 2013

Contents

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

California State Auditor

Elaine M. Howle State Auditor
Doug Cordiner Chief Deputy

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, in accordance with the 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, 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, 2013, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated April 16, 2014. Our report includes a reference to other auditors who audited the financial statements of the following, as described in our report on the State's financial statements:

Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 86 percent of the assets and deferred outflows and 32 percent of the revenues of the business-type activities.

- The University of California and the California Housing Finance Agency that represent 93 percent of the assets and deferred outflows, and 92 percent of the 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.

- The Golden State Tobacco Securitization Corporation, the Public Employees' Retirement, the State Teachers' Retirement, the State Water Pollution Control, and the 1943 Veterans Farm and Home Building funds, that represent 85 percent of the assets and deferred outflows, and 51 percent of the additions, revenues, and other financing sources of the aggregate remaining fund information.

- 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. The financial statements of the Golden State Tobacco Securitization Corporation, the Public Building Construction, the Public Employees' Retirement, the State Lottery, the Water Resources, and the 1943 Veterans Farm and Home Building funds were not audited in accordance with *Government Auditing Standards.*

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of California's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 2013-3 through 2013-6.

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 2013-2.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of California's financial statements are free from 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 2013-1.

The State of California's responses 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. The State's responses were not subjected to the auditing procedures applied in the audit and, accordingly, we express no opinion on them.

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the State'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's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CALIFORNIA STATE AUDITOR

John F. Collins II

JOHN F. COLLINS II, CPA
Deputy State Auditor

April 16, 2014

Schedule of Findings

STATE OF CALIFORNIA
SCHEDULE OF FINDINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unmodified
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

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

CALIFORNIA COMMUNITY COLLEGES CHANCELLOR'S OFFICE

Reference Number: 2013-1

Condition

The California Community Colleges Chancellor's Office (Chancellor's Office) authorized $48.5 million in general apportionments to three community college districts that were not entitled to receive such amounts between fiscal years 2005–06 and 2011–12. In fiscal year 2012–13, the Chancellor's Office stopped distributing general apportionment funding to districts that do not meet the criteria set forth in the Education Code. However, it has not recovered the $48.5 million in general apportionments that it paid to the three community college districts without explicit legal authority.

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 the Education Code, 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.

Between fiscal years 2005–06 and 2011–12, revenues for three of the State's 72 community college districts—Mira Costa, Marin, and South Orange—exceeded their apportionment target. However, while these districts did not meet the criteria set forth in the Education Code to receive general apportionment funding, the Chancellor's Office authorized such funding for each of those seven years. Annually, these amounts ranged from $3 to $8.7 million between fiscal years 2005–06 and 2011–12.

When we first reported a finding on this issue (i.e., fiscal year 2010–11), the Director of Fiscal Services of the Chancellor's Office (director) stated that the Chancellor's Office authorized a portion of general apportionment funding to the three districts each year between fiscal year 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, the Chancellor's Office did not present 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" for fiscal years 2007–08 through 2011–12. 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

The following criteria were in effect during fiscal years 2005–06 through 2011–12:

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 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 disagrees that the prior payments should be recovered from the community college districts. It believes that the prior payments were made due to a reasonable administrative interpretation of the situation for the following reasons:

- Basic aid districts received the Partnership for Excellence 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 that continuation of funding in the context of the 2004 Budget Act language as intent to permanently continue the funding for all districts, including basic aid districts.

When the Legislative Analyst's Office brought the Partnership for Excellence 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 subsequent phasing out of payments to basic aid districts. As indicated above, as of fiscal year 2012–13, the Chancellor's Office stopped distributing general apportionment funding to basic aid districts.

The Chancellor's Office believes that compelling the Mira Costa, Marin, and South Orange Community College Districts to repay funds allocated over a number of prior years due to a revision in understanding of earlier legislative intent would create a hardship for those districts. Rather, it believes its solution to deal with the issue prospectively represents satisfactory corrective action.

Auditor's Comments on the Chancellor's Office's View

The Chancellor's Office authorized $48.5 million in general apportionments to three community college districts that were not entitled to receive such amounts between fiscal years 2005–06 and 2011–12. Consequently, the amount of funding available for the remaining 69 community college districts was reduced by this amount. We continue to believe that the Chancellor's Office should recover the $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 OF DEVELOPMENTAL SERVICES

Reference Number: 2013-2

Condition

The Department of Developmental Services (DDS) significantly understated its General Fund liabilities for fiscal year 2012–13. Specifically, DDS failed to accrue $227 million of accounts payable owed to regional centers for services they provided during fiscal year 2012–13. In accordance with the Welfare and Institutions Code, the State enters into five-year contracts with regional centers to provide services to individuals with developmental disabilities, subject to annual appropriations of funds by the Legislature. These contracts specify the amount allocated to each of the five fiscal years covered by the contracts. However, DDS did not estimate and record a liability for services performed, but not invoiced, by these regional centers during fiscal year 2012–13. After we pointed out this error, DDS submitted an appropriate adjustment to the State Controller's Office (Controller's Office) to record this $227 million liability.

In addition, DDS overstated expenditures in fiscal year 2011–12 by not reestablishing an accrual for reimbursements related to the prior fiscal year. In fiscal year 2012–13, DDS received these reimbursements which had the effect of understating current year expenditures. Consequently, DDS agreed that it was necessary for the Controller's Office to make an adjustment for $232 million to increase its beginning General Fund balance and current year expenditures to correct this misstatement.

Criteria

California Government Code Section 12461 requires the Controller's Office to issue an annual financial report that is prepared in accordance with generally accepted accounting principles (GAAP). The Controller's Office provides guidance to departments on the preparation of their year-end financial statements in its Year-End Financial Reports Information 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 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 an expenditure and liability to be recorded when the liability has been incurred and when it will be paid with current financial resources.

Recommendation

To ensure its financial statements are properly presented at fiscal year-end, DDS should revise its procedures to report expenditures, including reimbursements, and liabilities for all the governmental funds it manages on the modified accrual basis.

Department's View and Corrective Action Plan

DDS has corrected the financial statements for fiscal year 2012–13 to address the audit findings above.

In addition, DDS has set up year-end processes to accrue reimbursements and regional center contract balances in the first year of the appropriation and adjust these accruals to reflect unrealized reimbursements and unliquidated contract balances in each of the subsequent open years of the appropriations. DDS will use common state accounting practices to identify the estimated reimbursements and expenditures in each year that it accrues these amounts.

DEPARTMENT OF HEALTH CARE SERVICES

Reference Number: 2013-3

Condition

The Department of Health Care Services (DHCS) understated Medi-Cal expenditures and revenues for fiscal year 2012–13 in the Federal Trust Fund by $865.9 million and $1.8 billion, respectively. Additionally, DHCS understated Medi-Cal expenditures and revenues for fiscal year 2012–13 in the Public Hospital Investment, Improvement, and Incentive Fund and the Hospital Quality Assurance Revenue Fund by $357.2 million and $82.5 million, respectively. 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. As a result, DHCS must prepare GAAP adjustments to convert its budgetary reports to the modified accrual basis for proper presentation in the State's Comprehensive Annual Financial Report. The following sections provide more detail about DHCS' understatements by program.

Understated Accruals for the Specialty Mental Health Consolidation and the Delivery System Reform Incentive Pool Programs

DHCS understated expenditures and related revenues by $426.2 million in the Federal Trust Fund for the Specialty Mental Health Consolidation program (Mental Health program), which provides specialty mental health services for MediCal recipients that meet medical necessity criteria. Additionally, DHCS understated expenditures and related revenues by $357.2 million in the Federal Trust Fund and $357.2 million in the Public Hospital Investment, Improvement, and Incentive Fund for the Delivery System Reform Incentive Pool (Incentive Pool) program, which supports California's Designated Public Hospitals' efforts by providing federal funds for four program areas. These areas include infrastructure development, innovation and redesign, population-focused improvement, and urgent improvement in care.

The understatements occurred because DHCS used a flawed accrual methodology, calculating its accruals based only on the portion of expenditures it had estimated it would pay out by June 30, 2013. These estimates did not cover expenditures for services provided by June 30 that DHCS expected to pay in the following fiscal year. According to the employee in the DHCS Accounting Section responsible for compiling the Medi-Cal accrual, DHCS operates on a cash basis during the fiscal year and the resulting accrual estimates were based on the difference between DHCS's budgeted spending authority and the amounts it had paid as of June 30, 2013. As discussed above, GAAP requires the use of the modified accrual basis of accounting for governmental funds. By not accruing Medi-Cal expenditures and related revenues as required by GAAP, DHCS risks materially misstating the Medi-Cal related expenditures and revenues it reports.

Understated Accruals for the Hospital Quality Assurance Fee—Hospital Payments program

DHCS also understated its Hospital Quality Assurance Fee—Hospital Payments (Hospital Payment) program expenditure and related revenue accruals by approximately $82.5 million each in the Hospital Quality Assurance Revenue Fund. Additionally, DHCS understated expenditures and related revenues for this program in the Federal Trust Fund by $82.5 million and $1 billion, respectively. 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 healthcare 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. DHCS relied heavily on estimates when calculating the managed care portion of its Hospital Payment program accruals although actual data on related billings was available. It submitted invoices to hospitals in mid-August 2013 for managed care quality assurance fees related to the prior fiscal year. For the last two fiscal years, 2011–12 and 2012–13, DHCS has ultimately received about 96 percent of the billed amounts. As such, the actual billed amount adjusted by a historical collection rate offers a more reliable basis for preparing the accrual than the estimate calculated by the Quality Assurance Fund Unit. In this case, DHCS billed $677.8 million and collected $658.9 million or $82.5 million more in quality assurance fees than its accrual for fiscal year 2012–13 of $576.4 million. Because DHCS matches these fees with federal funds it also understated Federal Trust Fund expenditures by the same amount. Additionally, DHCS failed to accrue corresponding Federal Trust Fund revenues for the Hospital Payment program. These revenues amounted to about $1 billion. According to the employee in the Accounting Section responsible for compiling the Medi-Cal accrual, DHCS omitted the Federal Trust Fund revenues from the Hospital Payment program accruals by mistake. We found that DHCS' process for developing the Hospital Payment program accrual omitted the creation of accounting entries related to Federal Trust Fund revenues. Without a complete process to guide its staff in preparing the accruals, DHCS risks materially misstating Medi-Cal accruals in the future.

Criteria

California Government Code Section 12461 requires the State Controller's Office (Controller's Office) to issue an annual financial report that is prepared in accordance with GAAP. To prepare its financial report, the Controller's Office annually requests that departments submit GAAP-related adjustments for the funds they manage.

Governmental Accounting and Financial Reporting Standards 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.

The Controller's Office provides guidance to departments on the preparation of their year-end financial statements in its Year-End Financial Reports Information GAAP Basis Manual (GAAP manual). According to the GAAP manual, agencies should accrue liabilities and related expenditures for services provided prior to June 30 that will be paid in the following fiscal year.

Recommendation

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.
- Use actual data, when available, in the development of accruals.
- Develop a process to ensure it accrues all revenues related to the Hospital Payment program.

Department's View and Corrective Action Plan

Recommendation 1: DHCS agrees with the recommendation. Beginning with the next State fiscal year 2013–14, DHCS will report activity for all governmental funds under its management on a modified accrual basis. DHCS states it has begun drafting desk procedures that will provide instructions to current and future staff detailing how to produce a fiscal year end accrual using the modified accrual methodology.

Recommendation 2: DHCS agrees with the recommendation. Beginning with the next State fiscal year 2013–14, DHCS will use actual data in the development of its accruals. DHCS states it has begun a process of identifying the actual data and providing the staff responsible for the accrual development access to the needed data sources. DHCS will draft desk procedures that contain accrual reporting instructions which identify all the actual data sources and the related contacts for obtaining the actual data.

Recommendation 3: DHCS agrees with the recommendation. Beginning with the next State fiscal year 2013–14, DHCS states it has developed a process to ensure it accrues all revenues related to the Hospital Payment program.

DEPARTMENT OF TRANSPORTATION

Reference Number: 2013-4

Condition

In its fiscal year 2012–13 financial statements, the Department of Transportation (Caltrans) incorrectly reported balances related to the State's capital assets. Specifically, it reported to the State Controller's Office (Controller's Office) capital asset balances containing a net overstatement of about $900 million resulting from three separate errors.

The first error involved Caltrans' improper recognition of certain highway construction project costs as infrastructure assets. Under generally accepted accounting principles, Caltrans should record infrastructure additions and improvements as assets only if they increase an infrastructure asset's capacity or efficiency. Infrastructure additions and improvements that do not meet this criterion should be expensed as maintenance costs. During our audit of the fiscal year 2011–12 financial statements, we identified that Caltrans had inappropriately recorded the cost of two toll bridge seismic retrofit projects as infrastructure assets instead of as expenses, resulting in an overstatement of capital assets. Upon further investigation we recognized that Caltrans might have additional projects erroneously recorded as infrastructure, so we asked Caltrans to identify and analyze any other infrastructure projects that could cause its records to be misstated.

Caltrans produced two separate analyses of its infrastructure, one for potentially overstated projects and one for potentially understated projects. Its overstatement analysis identified categories of infrastructure assets containing projects that potentially should not have been recorded as assets. We tested projects in the identified categories and found that only the categories described as "seismic retrofit" contained project costs that should not have been recorded as assets. In total, these categories contained about $228 million of capital assets that should have been expensed as maintenance costs. Caltrans' understatement analysis identified regional projects that were never recorded as assets but potentially should have been. We tested the four largest identified projects and found that all four should have been recorded as assets, resulting in about $1.4 billion of unreported capital assets.

The second error involved Caltrans' improper reporting of infrastructure additions on its fiscal year 2012–13 financial statements. This resulted primarily from two significant errors. Caltrans overstated its infrastructure account balance by $1.2 billion due to the misapplication of adjusting entries meant to eliminate certain costs from the capital asset additions it reports. It also overstated its infrastructure work in progress account balance by $1.1 billion when it erroneously double-posted capital asset additions for one of its funds. It appears Caltrans could have avoided these errors by performing a more thorough review of its financial statements.

The third error involved Caltrans' failure to record and report two building projects that it received ownership of in fiscal year 2012–13. The Department of General Services (General Services) constructs buildings on behalf of state departments and upon project completion sends a notice to the department receiving the asset. The notice says that the department is required to record and report the asset. In fiscal year 2012–13, General Services completed construction of two building projects worth about $199 million on Caltrans' behalf and sent completion notices to Caltrans. Caltrans received the notices but did not correctly record or report the assets, resulting in an understatement of capital assets.

At fiscal year-end the Controller's Office gathers information on the State of California's capital assets from state departments and presents it in the Comprehensive Annual Financial Report (CAFR). When departments incorrectly report capital assets to the Controller's Office, it can cause the CAFR's capital asset balances to be misstated. Left uncorrected, Caltrans' capital asset errors would have been large enough to cause significant misstatements. We therefore communicated the errors we identified to Caltrans. It corrected its fiscal year 2012–13 financial reports for the infrastructure-related errors noted and indicated it would adjust its fiscal year 2013–14 financial information to correct the error related to buildings.

Criteria

Sections 1400.105 through 108 of the Governmental Accounting and Financial Reporting Standards apply to governments using the modified approach for reporting infrastructure assets. These sections allow a government to avoid depreciating its infrastructure assets as long as it maintains them at or above a condition level established and disclosed by the government. California uses this approach in accounting for its state highway system. It therefore expenses all costs used to maintain its infrastructure assets and only records costs as capital assets if they have increased the capacity or efficiency of the infrastructure system.

The *State Administrative Manual*, sections 7463, 7977 and 8660, requires state departments to report in their financial statements to the Controller's Office all additions and deductions to capital assets. The Controller's Office uses these reports to compile the information related to capital assets that it presents in the CAFR.

Recommendations

Caltrans should improve its processes for recording infrastructure costs. Specifically, its policies and procedures should allow it to, on an ongoing basis, properly identify and segregate infrastructure costs that it should record as expenses from infrastructure costs that it should record as capital assets.

To ensure that its financial statements do not contain significant errors, Caltrans should improve its process for reviewing the capital asset reports it submits to the Controller's Office. The process could include an analytical procedure that would compare capital asset amounts between the current year and the prior year to determine if current year amounts are reasonable.

Caltrans should develop procedures to ensure that it records and reports all capital assets it owns at fiscal year-end.

Department's View and Corrective Action Plan

Caltrans procedures have relied on coding structures for State Transportation Improvement Program and State Highway Operation and Protection Plan capital projects for purposes of distinguishing capital improvements that should be recorded as infrastructure costs and expenses. Caltrans will perform an in-depth evaluation of this approach and revise its procedures to ensure infrastructure is capitalized correctly. Additionally, Caltrans will incorporate analytical comparisons into its procedures to validate infrastructure reporting is reasonable when compared to prior year reporting. Finally, Caltrans will enhance its procedures to ensure it records as capital assets completed building construction.

DEPARTMENT OF TRANSPORTATION

Reference Number: 2013-5

Condition

The Department of Transportation (Caltrans) made significant errors in reporting its fiscal year 2012–13 financial information for the State Highway Account to the State Controller's Office (Controller's Office), and ultimately submitted required adjustments to the Controller's Office late. If uncorrected, the errors would have caused the material misstatement of business and transportation expenditures and accounts receivable in the State's Transportation Fund at June 30, 2013.

Effective fiscal year 2011–12, the Department of Finance (Finance) requires Caltrans to report its State Highway Account financial information on a cash basis for budgetary purposes. As a result, Caltrans must prepare generally accepted accounting principal (GAAP) adjustments dissimilar to those it historically submitted to convert its budgetary reports to the modified accrual basis for proper presentation in the State's Comprehensive Annual Financial Report (CAFR). According to the Chief of Caltrans' Office of Financial Accounting and Analysis, Caltrans' initial calculations of GAAP adjusting entries contained errors because written procedures were not updated to reflect the new reporting requirements. Caltrans' initial calculations incorrectly produced a modified accrual adjustment to expenditures of negative $591.9 million. The adjustment, if calculated correctly, would normally record additional expenditures related to services received by fiscal year-end that are expected to be paid in the subsequent year. The erroneous GAAP adjustment resulted in a $1.5 billion understatement of fiscal year 2012–13 business and transportation expenditures for the State Highway Account. This error, if uncorrected, would have been significant enough to cause a material misstatement of the Transportation Fund, one of the four major governmental funds presented in the State's CAFR. In a related GAAP adjustment, Caltrans also materially overstated its accounts receivable, submitting a GAAP adjustment of $1.6 billion. A portion of Caltrans' expenditures are normally reimbursed by others, leading to the recording of accounts receivable. For fiscal year 2012–13, Caltrans' gross overaccrual of its accounts receivable resulted in a $1.4 billion overstatement of this account. Subsequent to our inquiry, Caltrans calculated that the correct State Highway Account GAAP adjustment for expenditures should have been $880.1 million and that the correct adjustment for accounts receivable should have been $205.6 million. It submitted these adjustments to the Controller's Office on February 13, 2014.

Criteria

California Government Code Section 12461 requires the Controller's Office to issue a CAFR that is prepared in accordance with GAAP. To prepare the financial report, the Controller's Office annually requests that departments submit GAAP-related adjustments for the funds they manage. The Controller's Office's "Year-End Financial Reports Information—GAAP Basis" manual represents the Controller's Office's guidance to departments regarding GAAP adjustments. Specifically, the Controller's Office requires departments to accrue liabilities and related expenditures for unpaid services received prior to fiscal year-end that are expected to be paid within the next year. State Administrative Manual Section 7950 requires departments to prepare year-end reports soon after June 30 to meet the required due dates and to estimate accruals with reasonable accuracy. For fiscal year 2012–13, GAAP adjustments were due to the Controller's Office September 3, 2013.

The aforementioned guidelines are designed in part to ensure compliance with the requirements of the Governmental Accounting and Financial Reporting Standards Section 1600, which requires that financial statements for governmental funds be presented using the current financial resources measurement focus and modified accrual basis of accounting. The current financial resources measurement focus and the 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.

Recommendation

To ensure the accurate and timely submission of financial information for the State Highway Account to the Controller's Office, Caltrans should update its written procedures to guide its efforts in calculating required GAAP adjustments and reporting them in a timely manner to the Controller's Office.

Department's View and Corrective Action Plan

As the State Auditor indicates, the requirement to report State Highway Account activity on a cash basis was implemented to correctly align budgetary basis financial statements with Governor's Budget reporting, and resulted in a significant change in accounting practices for the State Highway Account. Caltrans had a great deal of communication with the Controller's Office regarding the fiscal year 2012–13 financial statement reporting for the State Highway Account. These communications continued beyond the financial statement reporting deadlines, and the procedures to be followed, including the calculation of the GAAP adjustments, were not easily determined. Caltrans will update its written procedures to be used for fiscal year 2013–14 for calculation of GAAP adjustments for the State Highway Account, and will seek concurrence from Controller's Office staff regarding the procedures.

STATE CONTROLLER'S OFFICE

Reference Number: 2013-6

Condition

The State Controller's Office (Controller's Office) did not perform the necessary level of due diligence to prevent and detect errors that if uncorrected would have caused the material misstatement of the State's Comprehensive Annual Financial Report (CAFR). Specifically, the Controller's Office implemented new accounting standards without sufficiently determining the impact of those standards on the CAFR. In addition, the Controller's Office improperly implemented a new process for developing entries to reverse prior year accruals, which resulted in multiple inaccurate entries. The Controller's Office also posted numerous inaccurate adjusting entries for current year activity because its staff followed desk procedures that were outdated or inadequate to guide them in performing their duties. Furthermore, we determined that the Controller's Office lacked a sufficient internal review process. Specifically, we found multiple instances of obvious misstatements that should have caused the Controller's Office to question whether an error had been made, including excessive understatements of liabilities and improperly reporting negative account balances. Finally, the Controller's Office submitted multiple note disclosures that contained significant errors in account balances and other required information. It is important to note that the Controller's Office's State Government Reporting Bureau within its Division of Accounting and Reporting, which is responsible for producing the CAFR, experienced significant turnover over the last three fiscal years. Specifically, from fiscal year 2009–10 to fiscal year 2012–13, the turnover rate for the bureau's staff was 30 percent. More significantly, the turnover rate for the bureau's middle managers and supervisors, who are responsible for reviewing staff work products, was 75 percent during this period. Similarly, the turnover rate for the division's upper managers who are responsible for supervising the bureau, including the division chief, an assistant division chief, and a bureau chief, was 100 percent. These high turnover rates likely contributed to a number of the issues described in this finding.

The Controller's Office Struggled to Effectively Implement New Standards

The Controller's Office did not always perform adequate due diligence when implementing five new standards in fiscal year 2012–13 that were issued by the Governmental Accounting Standards Board (GASB). We had several common concerns with the Controller's Office's implementation of these standards. Specifically, it did not begin to implement these new standards until the very latter part of fiscal year 2012–13, and in some cases did not finalize its implementation of these standards until early 2014 when our audit was nearly complete. In addition, the Controller's Office did not always gather sufficient evidence or perform effective analyses to determine the appropriate and complete impact of these new standards on the CAFR. Consequently, we sometimes had to perform our own analyses to determine how these new standards affected the accounting and reporting of certain types of transactions. Although these implementation deficiencies did not result in significant errors for four of the five new standards, the Controller's Office's efforts to implement one standard were particularly problematic.

Specifically, the GASB issued Statement Number 65 (GASB 65), Items Previously Reported as Assets and Liabilities, which establishes standards that reclassify certain items that were previously reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. Although GASB specified that this standard is effective for periods beginning after December 15, 2012, the Controller's Office chose to early implement it for fiscal year 2012–13. However, the Controller's Office did not send us its initial draft approach for implementing GASB 65 until May 2013, and it did not finish analyzing all of the potential effects of GASB 65 until March 2014. In the interim, the Controller's Office sent us numerous transmittals that included various analyses of the affects of GASB 65 on different types of transactions. However, it did not always gather sufficient evidence to support its conclusions, sometimes relying primarily on e-mail assertions from agencies. The Controller's Office's inadequate assessment of the effects of GASB 65 would have resulted in significant misstatements and a flawed disclosure if uncorrected as discussed in subsequent sections of this finding.

The Controller's Office Made Material Errors When It Reversed Prior Year Accruals

The Controller's Office prepared numerous erroneous reversing entries and posted these entries to its accounting system that if uncorrected would have caused the material misstatement of the State's financial statements. Initially, the Controller's Office understated Federal Trust Fund revenues and expenditures by $7.7 billion; it overstated General Fund assets and revenues by $653 million; and it overstated the revenues and expenditures or transfers out of the Non Major Governmental Funds by $1.7 billion. These errors also impacted the Governmental Activities in the Government-wide financial statements, which were also affected by an additional error that overstated liabilities and expenditures by $1.0 billion. Properly prepared adjusting entries are needed in specific instances to ensure the State's financial statements comply with applicable reporting standards. In the following year the Controller's Office must reverse those entries that represent prior year accruals to avoid the double reporting of activity; once when the underlying transaction occurs and then again when the cash is received or disbursed. However, the Controller's Office erroneously reversed several adjusting entries that did not represent prior year accruals, and failed to reverse other entries that did represent prior year accruals.

These errors occurred partly due to the improper implementation of a new process intended to assist in identifying prior year accruals; coupled with existing desk-procedures governing their reversal. Specifically, in fiscal year 2012–13 the Controller's Office implemented the use of an automatically generated excel-worksheet. This worksheet was populated with all the adjusting entries posted in the prior year for staff to analyze and identify those entries in need of reversal. However, this automated worksheet omitted the information needed to determine whether an adjusting entry was in fact an accrual that needed to be reversed. In particular, it did not list each individual transaction, but instead consolidated all transactions with the same document number into one entry. The Controller's Office assigns document numbers to track adjusting entries. Each numbered document may contain more than one transaction to address multiple objectives, which are described within the related "description" field. However, during the consolidation process, the description for the first transaction was applied to all of the transactions sharing the same document number in some cases, and in other cases this description was omitted altogether. Therefore the Controller's Office could not accurately identify which entries to reverse using this report.

Additionally, the Controller's Office's desk procedures governing this task are not adequate to guide staff in the performance of their duties. Specifically, the Controller's Office's desk procedures require that staff reverse any prior year adjusting entries impacting both a balance sheet and income statement account. Even though the prior year accruals meet this definition, these procedures do not explain or require staff to understand the purpose of these entries. As a result, the Controller's Office cannot be sure staff accurately select and reverse all appropriate adjusting entries. Additionally, while staff are required to reconcile beginning fund balance in order to ensure all reversing entries have been identified, the Controller's Office's procedures do not address the type of situation when the accrual includes the equal recognition of both revenues and expenditures, and therefore has no impact on fund balance, such as is generally the case for entries in the Federal Trust Fund. In fact the Federal Trust Fund experienced the greatest number of errors and had the most sizable misstatements related to reversing entries as previously mentioned.

The Controller's Office Improperly Prepared Numerous Current Year Adjusting Entries

The Controller's Office also prepared numerous erroneous adjusting entries related to current year activity, and posted these entries to its accounting system. Specifically, we noted a significant increase in the volume of adjusting entries, some of which can be explained. However, a large portion represents entries the Controller's Office inappropriately prepared and the multiple attempts to correct the resulting errors. These errors occurred because of the Controller's Office's failure to update its procedures to adjust to current circumstances, including the implementation of new standards. These weaknesses over financial reporting could result in material misstatements in future financial statements, if not corrected by the Controller's Office.

For example, the Controller's Office posted an excessive amount of adjusting entries prepared by multiple individuals to the Economic Bond Recovery Sinking Fund, a Non Major Governmental debt service fund. In the prior year, the State began accruing principal and interest payments scheduled within 30 days after fiscal year-end in the budgetary basis financial statements, which is appropriate. However, given the presentation differences between the budgetary basis and generally accepted accounting principles (GAAP) basis the Controller's Office needed to prepare a GAAP entry to reclassify the budgetary basis accrual from Accounts Payable to Interest Payable and General Obligation Bonds Payable. It also needed to reclassify the budgetary basis General Government expenditures related to debt service to Debt Service expenditures for GAAP, as it did in the prior year. However, the Controller's Office incorrectly reversed the prior year reclassification entry and caused the misstatement of $550 million in the impacted accounts for reasons discussed in the previous section. It then prepared and posted an adjusting entry erroneously accruing $624 million in debt service expenditures already accrued on the budgetary basis. This error occurred because the Controller's Office's desk procedures had not been updated to reflect the fact that the entry is now posted as a budgetary basis accrual. To correct these errors three different staff prepared and posted a series of nine adjusting entries.

Similarly, outdated desk procedures governing the Trial Court Operations Fund instructed Controller's Office staff to prepare and post an unneeded adjusting entry reclassifying Transfers In to Intergovernmental Revenue, and therefore, would have resulted in overstated revenues and understated transfers of $780 million. Specifically, the Controller's Office did not update its procedures to address a change in how the operations fund receives funding from the Trial Court Trust Fund. The operations fund reports the cost of trial court operations. The trust fund transfers money it receives from counties and other sources to the operations fund to assist in the funding of these costs. In the prior year, the administering department reported the county support as a transfer between these two funds. Therefore, the Controller's Office prepared and posted an adjusting entry that reclassified this support to Intergovernmental Revenues in the operations funds. In the current year, the department provided financial statements that reflected the proper classification of the county support making the adjusting entry posted by the Controller's Office unnecessary.

Additionally, the Controller's Office failed to update its desk procedures to ensure compliance with GASB standards. For example, in regards to GASB Statement Number 54 (GASB 54), Fund Balance Reporting and Governmental Fund Type Definitions, the Controller's Office posted an entry that would have understated the existing fund balance restrictions by $678 million for the Financing for Local Governments and the Public fund, a Non Major Special Revenue Fund. GASB 54 requires the classification of fund balance based upon the level of constraint imposed upon funding sources. Restricted fund balance represents the highest level of constraint; however, the standard does not permit the reporting of negative restrictions. Therefore, if fund liabilities exceed assets an entry is needed to reclassify the resulting negative fund balance as unassigned. The Controller's Office posted such an entry for this fund even though it did not have negative restrictions.

Similarly, the Controller's Office failed to update its procedures related to the implementation of GASB 65 for the Golden State Tobacco Securitization Fund. The Controller's Office annually prepares adjusting entries for the Golden State Tobacco Securitization Fund to convert the fund's statements from the accrual basis of accounting to the modified accrual basis of accounting, as required for proper presentation in the fund financial statements. Due to its improper implementation of GASB 65 and outdated procedures, the Controller's Office prepared entries that improperly reported $532.6 million in deferred outflows of resources that under the modified basis of accounting should not be reported in the fund financial statements. Additionally, the Controller's Office failed to record $56 million in proceeds from bond premiums and understated debt service expenditures by $600 million.

Moreover, we found that the Controller's Office initially understated the beginning balance of net position in the Government-wide financial statements for Governmental Activities by $634 million, which it incorrectly attributed to GASB 65 adjustments related to the refunding of general obligation bonds. However, we determined that these transactions should only have resulted in a reclassification of prior years' refunding gains and losses to deferred inflows of resources and deferred outflows of resources, respectively, and should not have resulted in a restatement of beginning net position. We provided the Controller's Office with guidance on how to correct this error.

The Controller's Office Lacked a Sufficient Review Process

The number and magnitude of errors we found indicate the Controller's Office lacks a sufficient review process to prevent and detect significant errors. For example, the Controller's Office could have prevented a $365 million understatement to the workers compensation liability and related expenditure accounts by performing a more robust review of its staff's work product. Specifically, the Controller's Office accrued a $46 million workers compensation liability rather than the correct amount of $411 million because staff relied on a report that included a keying error. The report provided to us did not contain any evidence the Controller's Office had verified the total liability by summing the columns, or that management had reviewed this information for accuracy. Furthermore, since the workers compensation liability has not been less than $300 million for any year within the last 10 years, the insignificance of the initial accrual should have caused a reviewer to question whether an error had been made.

Additionally, we found multiple instances of the Controller's Office reporting improper negative account balances. We believe such obvious misstatements should have been a strong indicator of a possible error. For example, the errors for the Golden State Tobacco Securitization Fund, previously discussed, resulted in the reporting of negative debt service expenditures of $292 million. In another example, the Controller's Office reported a negative $171.7 million in Due From Other Funds for the Self-Help Housing Fund (a component within the Financing for Local Governments and the Public fund). This error occurred because four different staff posted a series of five duplicate and erroneous adjusting entries in an attempt to simply reduce Due From Other Funds and various liability accounts for budgetary basis transactions that do not represent valid assets or liabilities on a GAAP basis. Finally, the Controller's Office also reported negative Deferred Revenues of $6.2 billion when its staff posted an entry with three additional zeros when reclassifying advanced tax collections.

The Controller's Office Inaccurately Prepared Required Disclosures

The CAFR prepared by the Controller's Office also includes certain note disclosures as required by GAAP. The Controller's Office's process for submitting note disclosures includes submitting a draft of the disclosure (transmittal) to the California State Auditor's Office (Auditor's Office) after staff prepare the transmittal and a supervisor reviews and approves it. The Controller's Office submitted multiple transmittals, signed and approved by supervisors, to the Auditor's Office with significant errors.

For example, the Controller's Office submitted certain transmittals that contained errors related to the implementation of GASB 65. Specifically, the Controller's Office incorrectly disclosed the reclassification of a previous loss on refunding related to the Golden State Tobacco Securitization Corporation bonds as fiscal year 2012–13 activity, displaying it as a deduction in the governmental activities portion of the schedule of changes in Note 10, instead of as a restatement of the beginning balance. GASB 65 states that a loss on the sale of refunding bonds does not represent an obligation, but instead meets the definition of a deferred outflow of resources. It also specifies that any changes in accounting principle resulting from this definition should be applied retroactively. As a result, the Controller's Office should reflect a change resulting from the implementation of GABS 65 as a restatement of the beginning balance, not as activity of the current fiscal year.

In another example, the Controller's Office reported incorrect revenue bond outstanding balances for three funds in the business-type activities portion of the Schedule of Revenue Bonds Outstanding in Note 16. Specifically, it switched the balances between the Water Resources Fund, the Public Building Construction Fund and the California State University. As a result, the Controller's Office understated the Public Building Construction Fund by $9.1 billion, and overstated the California State University and Water Resources Fund's Revenue Bonds Outstanding by $8 billion and $1.1 billion, respectively. The Controller's Office also incorrectly disclosed the amount of the future debt service in the Schedule of Debt Service Requirements for Revenue Bonds. Specifically, it consolidated the amounts of the future debt service payments for years 2029–2038 into one row instead of separating the debt service payments for this time period into 5-year increments as required by GASB. By consolidating the future debt service payments, the Controller's Office overstated total debt service requirements for 2029–2033 by $1 billion, and understated 2034–2038 by the same amount in its transmittal. Finally, the Controller's Office omitted an issuance of Enhanced Tobacco Settlement Asset-backed bonds used to refund a portion of the outstanding series 2005A bonds in its Note 16 disclosures.

Criteria

California Government Code Section 12460 requires the Controller's Office to annually issue two financial reports; each adhering to separate accounting principles. The first, the State's Budgetary/Legal Basis Annual Report, conforms to the Governor's Budget and the Budget Act; and serves as the starting point for the CAFR, the second report. The CAFR must conform to GAAP. When the budgetary basis rules differ from those of GAAP the Controller's Office (or applicable department) must prepare adjusting entries to bring the financial statements into compliance with GAAP. For instance, if the budgetary basis rules require the recognition of revenues or expenditures on a cash-basis, adjusting entries are needed to accrue certain transactions under GAAP. To prepare its financial report, the Controller's Office annually requests that departments submit GAAP-adjusting entries for the funds they manage. However, it is the Controller's Office's responsibility to reverse these accruals in the following fiscal year. In certain limited instances, the Controller's Office prepares additional adjusting entries to ensure the department entries are in compliance with GAAP.

The Controller's Office has established desk procedures to guide its staff in preparing the CAFR. Additionally, the Controller's Office is responsible for designing, implementing, and maintaining processes relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error. An independent audit conducted in accordance with generally accepted auditing standards does not act as a substitute for the maintenance of internal controls necessary for the preparation and fair presentation of financial statements by management.

The National Council on Governmental Accounting Statement Number 1, Section 157 specifies that notes to the financial statements are essential for fair presentation at the general purpose financial statements level and narrative explanations are useful in providing an understanding of combining and individual fund and account group statements and schedules.

GASB Statement Number 38 requires governments to disclose debt service requirements for principal and interest to maturity, presented separately, for each of the five subsequent fiscal years and in five-year increments thereafter.

GASB 54 requires governments to report fund balance for governmental funds in classifications that comprise a hierarchy based primarily on the extent to which the government is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. GASB 54 also prohibits governments from reporting negative restricted, committed, or assigned fund balances in any fund.

GASB 65 states that the difference (e.g. gains and losses) resulting from a current refunding of debt, or an advance refunding of debt, reported by governmental activities, business-type activities, and proprietary funds, relates to future periods and, therefore, meets the definition of a deferred inflow of resources or deferred outflow of resources, as applicable. Additionally, GASB 65 states that accounting changes adopted to conform to the provisions of the statement should be applied retroactively by restating the financial statements, if practical, for all periods presented. If restatement is not practical, the cumulative effect of applying this statement, if any, should be reported as a restatement of beginning net position or fund balance, as appropriate, for the earliest period restated.

Recommendations

To effectively implement new standards, the Controller's Office should:

- Develop sound methodologies for implementing new accounting standards in the year prior to their effective date, whenever feasible. This is particularly important for complex standards like GASB 65.

- Provide specific implementation instructions to agencies and obtain any information including supporting documentation that the Controller's Office needs to properly assess the impact of new standards on the CAFR.

- Update its internal procedures to effectively address changes in accounting standards, as necessary.

- Develop effective procedures that ensure that all material impacts on the CAFR are considered when implementing new accounting standards. This should include a methodology for identifying all accounts and types of transactions that could potentially be affected by a new standard and any agencies with material activity.

To ensure the CAFR is properly presented at fiscal year-end, the Controller's Office should:

- Develop a more formal process for reviewing and approving entries before posting them into its GAAP accounting system.

- Develop a process to review financial statements after entries are posted to ensure the accuracy of account balances.

- Develop a process to evaluate its desk procedures annually and update them as necessary.

- Develop and implement proper controls to thoroughly evaluate the effectiveness of any newly developed procedures.

- Provide guidance and training to staff to ensure they understand key accounting concepts and the purpose of the tasks they perform.

Department's View and Corrective Action Plan

Executive Summary

The State Controller's Office (SCO) acknowledges that it needs to strengthen its processes regarding the implementation of new standards, reversing and adjusting entries, reviewing staff work, and preparing required disclosures to the financial statements. It should be noted, however, that the Controller received an unmodified opinion or unqualified opinion on the financial statements for fiscal year 2012–13, as it has each year over the past ten years. The SCO concurs with the California State Auditor's (CSAs) notation and believes that the challenges of high staff turnover and in recruiting qualified staff significantly contributed to the issues identified. Other contributing factors included budget cuts and denial of financial resources, as well as poor quality and late submission of the financial data by numerous agencies. For fiscal year 2012–13, at least 178 financial statements required revisions. In addition, 111 statements were submitted late. The substandard, inaccurate, and late statement submissions delayed the start of the CAFR tasks and caused additional work to be performed, thereby, reducing the amount of resources available for SCO staff to complete the expected workload within the planned timeline.

The SCO agrees with the CSA's recommendations regarding implementing new standards and preparing the Comprehensive Annual Financial Report (CAFR), and began taking the appropriate actions by:

- Hiring additional staff in the Policy/Quality Assurance unit and contracting with an external accounting firm with governmental accounting standards expertise to provide additional resources and guidance in the implementation of new accounting standards;
- Working more closely with State agencies to ensure that they are aware that they are responsible for providing and retaining documentation to support their responses and assertions regarding new accounting standards;
- Requiring staff to review and update desk procedures for the fiscal year 2012–13 CAFR by April 25, 2014 and, also, requiring that any changes to tasks or procedures be memorialized within 30 days of the change. The SCO also will add a requirement that the Policy/Quality Assurance unit must update existing desk procedures for any new standards as soon as the impact of a new standard can be determined.
- Developing an additional quality assurance review process to ensure that desk procedures are updated timely;
- Providing more one-on-one and group training to ensure that all staff understand the CAFR tasks to be performed;
- Adopting more stringent and robust analysis and review requirements by using an internal reviewer checklist to further aid in the review of the CAFR tasks, and requiring reviewers to use the Government Finance Officers Association (GFOA) disclosure checklist to ensure that financial statement disclosures are accurate and adequate; and
- Initiating a third-level review of staff work, as needed, relative to the complexity of each task, to ensure that work performed is accurate, until staff are fully trained.

In addition, based on its own internal review of the CAFR process and discussions with staff, the SCO will pursue the following actions:

- Create core courses that all staff who perform CAFR tasks must attend to ensure that staff members possess the necessary governmental accounting knowledge and expertise;
- Continue the SCO's annual open house and expand the effort with a focus on those State agencies that submit late or incorrect statements and reports;
- Create a presentation for State departments so that they understand the importance of submitting correct financial statements as well as the significance and magnitude of the CAFR on the State's ability to conduct business;
- Explore with the Department of Finance (DOF) the possibility of increasing the number and frequency of State fund accounting courses being offered to State agencies;
- Continue to pursue with California Department of Human Resources (CalHR), an SCO- specific accounting classification with appropriate compensation, and commensurate with the work to be performed. The SCO also will explore using recruitment and retention bonuses as an option;

- Follow-up with the agencies that submit late, incorrect, and/or inconsistent reports by performing site visits. Currently, Government Code Section 12461.2 allows the Controller to withhold operating funds for an agency that submits late year-end financial reports. The SCO will explore the possibility of modifying the Government Code to allow the Controller to also withhold the agency or department director's salary until the financial statements are submitted properly;

- Contact the DOF to explore the possibility of changing the required due dates of year-end financial reports. Beginning with the fiscal year 2013–14 report submissions, the SCO will post on the SCO website, a list of agencies that submit late reports; and

- Explore the possibility of introducing new, or changing existing legislation, to adhere more closely to a GAAP-based standard.

These proposals and actions are discussed in more detail later in this document.

SCO Response

The SCO acknowledges the issues raised by the CSA and is in process of implementing appropriate actions to correct the concerns noted. Annually, the State Government Reporting (SGR) Bureau within the SCO's Division of Accounting and Reporting (DAR) is tasked with responsibility for compiling and producing a CAFR using antiquated information technology systems, relying on agency-submitted financial information, and manually completing more than 950 individual tasks, with varying degrees of complexity. As noted by the CSA, staffing shortages and significant turnover contributed to many of the issues they identified. In addition, being denied additional resources and disparate classifications and compensation have added to the deficiencies.

- Over the past three years, the SGR has experienced serious staffing shortages, and had a vacancy rate of approximately 50 percent in November of 2013, just as the CAFR cycle was beginning. The high turnover rate primarily has been a result of prolonged and excessive overtime existing SGR staff have been required to work in order to produce the CAFR. The staffing shortage included managerial positions that had been vacant for about three years for want of qualified candidates, who bring appropriate knowledge and understanding of governmental accounting and reporting—qualifications which are critical to managing and producing the CAFR.

- The table below shows that in five of the last seven fiscal years, the SCO has been denied, through the budget process, the personnel resources needed to ensure that SGR is adequately and appropriately staffed.

FISCAL YEAR	POSITIONS REQUESTED	POSITIONS APPROVED
2008–09	2.0	2.0
2009–10	1.6	0
2010–11	5.0	0
2011–12	2.0	0
2012–13	–	–
2013–14	5.3	0
2014–15	5.3	0

In addition, in 2009, former Governor Schwarzenegger vetoed DOF-approved budget items and cut 10 percent of the SCO's budget just as the SCO was planning to add personnel more DAR resources.

After six years of being denied resources, the Controller was left with no choice but to utilize savings in other areas to hire additional staff. Since November of 2013, DAR has hired 12 staff and, out of necessity, temporarily redirected seven existing staff from other DAR programs and SCO Divisions to perform CAFR work. If these personnel changes had not been made, the CAFR would not have been completed in April of 2014. Although most of the new staff possessed college degrees in accounting and otherwise met the State minimum qualifications for the classifications, many did not have the necessary experience in governmental accounting, implementing new accounting standards, and preparing the CAFR. Staff inexperience is clearly evident because of the 28 staff who worked to prepare the fiscal year 2012–13 CAFR, 18 (64 percent) had less than one year of CAFR preparation experience, and 20 (71 percent) had less than two years of experience.

- A classification and compensation study initiated by DAR and performed by independent consultants during 2011 and 2012 concluded that the classification and compensation structure within DAR was not competitive enough to effectively recruit and retain qualified staff, particularly in SGR. The study recommended that an-SCO-only classification with a higher salary range be established. The SCO approached the Department of Personnel Administration (now CalHR) to remedy this, but the proposal was denied because CalHR did not want to modify the classification structure. The table that follows illustrates this point for the Accounting Administrator I (Specialist) classification.

State Controller's DAR	Accounting Administrator I, Specialist	$5,874

OTHER ENTITIES	COMPARABLE JOB CLASSIFICATION	MONTHLY SALARYMAX
State Dept. of Finance	Staff Finance Budget Analyst	$6,433
Administrative Office of the Courts	Senior Accountant	6,883
Santa Clara County	Senior Accountant	7,686
Los Angeles County	Senior Accountant, A-C	7,366
Orange County	Senior Accountant/Auditor I	6,554
Sacramento County	Senior Accountant	6,431
San Diego County	Sr. Auditor & Controller Accountant	6,245
Contra Costa County	Accountant III	6,183
Riverside County	Senior Accountant	5,209
MEAN		**$6,554**
MEDIAN		**$6,433**

With regard to each of the deficiencies noted, the SCO worked with the CSA to immediately understand and correct the deficiency when it was brought to the SCO's attention. This allowed the CSA to render an unmodified opinion on the financial statements. In fact, most of these deficiencies were corrected by March 28, 2014, when the unaudited financial statements were issued. In response to each of the deficiencies noted:

The Controller's Office Struggled to Effectively Implement New Standards

150 Percent Increase in New GASBs Implemented in Fiscal Year 2012–13

As noted in the following table, the number of GASBs implemented more than doubled in fiscal year 2012–13.

FISCAL YEAR				
2008–09	2009–10	2010–11	2011–12	2012–13
2	2	2	2	5

For fiscal year 2012–13, the SCO implemented five new accounting standards:

- GASB 60—Accounting for Service Concession Arrangements;
- GASB 61—The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34,
- GASB 62—Codification of Accounting and Financial Reporting Guidance Contained in Pre November 30, 1989 FASB and AICPA Pronouncements,
- GASB 63—Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position and
- GASB 65—Items Previously Reported as Assets and Liabilities.

GASB 65 Early Implementation

GASB 63 deals with financial reporting of deferred outflows and inflows of resources and their effects on net position, and goes hand-in-hand with GASB 65, which reclassifies certain items that were previously reported as assets and liabilities to deferred outflows and inflows of resources. The SCO chose early implementation of GASB 65 for the following reasons:

- Of the five new standards in fiscal year 2012–13, three standards, GASB 60, 63 and 65, required restatements of fund balances. Early implementation of GASB 65 allowed for more clear and consistent presentation of financial statements by showing the prior period adjustments in one year.
- The GFOA recommended, and the GASB encouraged early implementation of GASB 65 in conjunction with GASB 63.
- Industry audit and accounting professionals recommended concurrent implementation of GASB 63 and 65.

The SCO's process for implementing new accounting standards has been to work collaboratively with CSA by proposing our approach and methodology and requesting feedback and concurrence that our methodology and approach were appropriate and would provide accurate results to ensure successful implementation of the new standards.

Golden State Tobacco Securitization Fund

The CSA raised a number of issues regarding the implementation of GASB 65 and the Golden State Tobacco Securitization Fund (Tobacco Fund). These issues can be attributed to the incorrect sequencing of tasks in the CAFR plan, which caused the work to be performed out of order. As a result, a SCO policy analyst was analyzing the impact of GASB 65 transactions on the Tobacco Fund, at the same time an SCO accounting analyst was completing the actual CAFR tasks. Unfortunately, the SCO accounting analyst transmitted the CAFR tasks to the CSA for review prior to receiving guidance on the impact of GASB 65 on the Tobacco Fund, and the SCO was not able to correct the error prior to CSA auditing the tasks and finding the errors.

The SCO has already begun taking corrective action by hiring additional staff in the Policy unit and contracting with an external accounting firm with GASB expertise to provide more resources guidance, and training in the implementation of new accounting standards.

The Controller's Office Made Material Errors When It Reversed Prior-Year Accruals

The SCO acknowledges that the process for identifying and analyzing which entries need reversal could be improved. The errors regarding the Federal Trust Fund occurred because the desk procedures were not updated. By way of background, on average, 450 federal trust fund transactions must be keyed as part of the CAFR task. During the fiscal year 2011–12 CAFR cycle, the SCO developed the automatically generated Excel worksheet as a process improvement to reduce key data input of federal transactions and streamline the task. Additional procedures were written to explain how the Excel worksheet was to be used; however, due to high staff turnover, the existing desk procedures were not updated, which caused unintended downstream errors. Consequently, staff members working on this task for the FY 2012–13 CAFR used the Excel worksheet to bring in the federal transactions but failed to perform the required analysis to identify the entries requiring reversal.

The desk procedures for this task have been updated and we are beginning to train staff on the proper use of this Excel worksheet. In addition, the SCO now requires that any changes in tasks or procedures related to these matters are memorialized within 30 days of the change.

The Controller's Office Improperly Prepared Numerous Current Year Adjusting Entries

The SCO acknowledges that the process for preparing adjusting entries could be improved. However, it should be noted that posting several adjusting journal entries during the closing process is not uncommon in any entity, public or private. The observed increase in adjusting entries had several causes:

- Prior year changes or updates to desk procedures were not memorialized due to staff turnover. Consequently, the SCO made errors during the 2012–13 CAFR cycle that could have been avoided if the procedures had been properly updated.

- Misassignment of CAFR tasks resulted in multiple staff performing the same or related tasks, which in turn resulted in multiple attempts to correct the errors.

- Several agencies submitted poor quality and/or late reports of the financial data. For fiscal year 2012–13, at least 178 financial statements required revisions. In addition, 111 statements were submitted late. The inaccurate and late statements delayed the start of the CAFR tasks, and caused additional unanticipated work to be performed, thereby, reducing the amount of SCO staff time available to complete CAFR tasks.

- Financial statements are prepared on various accounting bases (cash, modified accrual and full accrual) depending on the type of fund that is being reported. The SCO receives various audit reports using the full accrual basis of accounting that must be analyzed and, by necessity, revised (requiring adjusting entries) to the modified accrual basis of accounting. In addition, there are various cash basis funds that require the SCO to revise and report on the modified accrual basis of accounting.

The SCO already has begun the process of ensuring that the desk procedures for all CAFR tasks have been updated, by requiring staff to review and update desk procedures by April 25, 2014, and will soon begin a quality assurance review of the desk procedures and provide training to all staff to ensure that these types of errors are reduced in the future. Also, the SCO will require that any changes in tasks or procedures are memorialized within 30 days of the change.

The Controller's Office Lacked a Sufficient Review Process

The SCO acknowledges that the review process needs to be strengthened. The worker's compensation error was corrected immediately once it was brought to the SCO's attention.

In late January of 2014, the SCO's management instituted an internal reviewer checklist to aid managers/supervisors with reviewing and approving work prior to its submission to the CSA. Following best practices, the SCO will adopt more stringent and robust analysis and review requirements by:

- Validating the mathematical accuracy of agency submitted numbers and reports;
- Comparing prior year balances to current year;
- Performing reasonable checks;
- Investigating abnormal balances;
- Using multiple levels of review and approval, and
- Performing quality assurance reviews to ensure that desk procedures are updated for changes to CAFR tasks.

As the SCO relies on agencies to provide valid, quality documents, it is reasonable to expect that agencies submit correct financial statements and reports. The SCO tracks financial statement revisions. Since the beginning of the decade, as displayed in the table below, there has been a marked increase (52 percent) in incorrect or inaccurate financial statements submitted to SCO.

FISCAL YEAR		
2010–11	2011–12	2012–13
117	182	178

Not included in above table are the many emails from state agencies requesting budgetary/legal and GAAP revisions to financial statements.

For example, the Department of Parks and Recreation used the incorrect revenue code to report $2.1 million in revenue in its year-end financial reports. This caused the GAAP statements to be out of balance because the revenue code did not exist in the GAAP system. In another example, the Department of Health Care Services submitted year-end financial statements that were out of balance by $806 million (assets did not equal liabilities).

Submission of inaccurate or incorrect statements delays the start of the CAFR tasks and causes additional work to be performed; thereby, reducing the amount of time available for SCO staff to complete and review CAFR tasks.

In addition to applying a more stringent and robust analysis and review process, SCO will work with State agencies and the DOF, as they are statutorily responsible for agency accounting policy, to address the rising number of errors in agency submitted financial reports and any training needed to reduce this trend.

The Controller's Office Inaccurately Prepared Required Disclosures

The SCO acknowledges that the process used to prepare the required disclosures should be strengthened. The SCO believes that the root cause of this problem is high staff turnover. As previously noted, 64 percent of staff assigned to work on the CAFR had less than one year of CAFR preparation experience. The three bullets below are examples of errors that can and will be corrected through training.

- The error described by the CSA in the Schedule of Revenue Bonds Outstanding in Note 16 was a transposition error that should have been identified during the review process.

- Incorrect financial information provided by two State agencies contributed to the error in the Schedule of Debt Service Requirements; however, this error also should have been identified during the review process.

- The omission of the Enhanced Tobacco Settlement Asset-Backed Bonds occurred due to staff turnover, as the SCO analyst performing the task was inexperienced, having less than one year of experience in performing CAFR tasks.

In addition to conducting enhanced training, the SCO already has initiated a more robust review process using an internal reviewer checklist that requires reported information to be compared with source documents and the GFOA disclosure checklist to help ensure that the required disclosures were included in the CAFR.

Response to CSA Recommendations

Recommendation:

To effectively implement new standards, the Controller's Office should:

- Develop sound methodologies for implementing new accounting standards in the year prior to their effective date, whenever feasible. This is particularly important for complex standards like GASB 65.

SCO's Response

The SCO has not always had the resources to work on the implementation one year prior to the effective date of the standard. In late April/early May 2014, the SCO hired additional staff in the Policy unit and contracted with an external accounting firm with GASB expertise to provide more resources and guidance in the implementation of new accounting standards.

- Provide specific implementation instructions to agencies and obtain any information including supporting documentation that the Controller needs to properly assess the impact of new standards on the CAFR.

SCO's Response

The SCO has developed specific implementation instructions based on the accounting standards, and has provided the instructions to the CSA for review and input. However, agencies are not as cooperative as they should be in response to the SCO's implementation instructions. The SCO will follow up more thoroughly with agencies and ensure that they are aware that they are responsible for retaining documentation to support any responses and assertions they submit to the SCO. In addition, the SCO will require agency directors to certify, in writing, that their department evaluated the existence of transactions related to new standards such as GASB 60 and 65. However, the SCO is limited in its ability to collect this information as it is dependent on the expertise of staff within the agencies and their understanding of new GASB standards.

- Update its internal procedures to effectively address changes in accounting standards, as necessary.

SCO's Response

The SCO already had begun the process of ensuring that the desk procedures for all CAFR tasks have been updated by requiring staff to review and update desk procedures by April 25, 2014, and will soon begin a quality assurance review of the desk procedures and training of staff to ensure that they understand the procedures to be followed. The SCO also will add a requirement that the Policy/Quality Assurance unit must update existing desk procedures for any new standards. Further, the SCO will require that any changes in tasks or procedures be memorialized within 30 days of the change. During each staff exit interview, the SGR manager will confirm that any changes to procedures have been memorialized.

- Develop effective procedures that ensure that all material impacts on the CAFR are considered when implementing new accounting standards. This should include a methodology for identifying all accounts and types of transactions that could potentially be affected by a new standard and any agencies with material activity.

SCO's Response

In late April/early May 2014, the SCO hired additional staff in the Policy unit and contracted with an external accounting firm with GASB expertise to provide more resources and guidance in the implementation of new accounting standards.

To ensure that the CAFR is properly presented at fiscal year-end, the Controller should:

- Develop a more formal process for reviewing and approving entries before posting them into its GAAP accounting system.

SCO's Response

In late January of 2014, the SCO implemented a more formal process for reviewing and approving entries—all work was to be reviewed and signed off by management. SCO will provide more one-on-one staff and managerial training to ensure that the proposed entries are correct before posting.

- Develop a process to review financial statements after entries are posted to ensure the accuracy of account balances.

SCO's Response

The SCO has relied on a supervisory/managerial review to ensure that work is performed correctly. However, due to high staff turnover, the SCO will add an additional quality assurance review. The SCO began implementing its corrective action by hiring an additional manager in May of 2014. Among the manager's duties will be to develop and implement an additional quality assurance review process to ensure the accuracy of the financial statements. This new process will be layered on top of reviews already being performed.

- Develop a process to evaluate its desk procedures annually and update them as necessary.

SCO's Response

The SCO already had begun the process of ensuring that the desk procedures for all CAFR tasks have been updated by requiring staff to review and update desk procedures by April 25, 2014, and will soon begin a quality assurance review of the desk procedures and training of staff to ensure that they understand the procedures to be followed.

- Develop and implement proper controls to thoroughly evaluate the effectiveness of any newly developed procedures.

SCO's Response

As part of its corrective action plan, the SCO will develop a quality assurance review process whereby newly developed procedures will be reviewed and tested to ensure the procedures yield the appropriate results before being implemented. Staff will then be trained on how to apply the new procedures.

- Provide guidance and training to staff to ensure they understand key accounting concepts and the purpose of the tasks they perform.

SCO's Response

The SCO began implementing its corrective action by hiring a manager in May of 2014, to assess the skill level of staff and provide one-on-one training and core curriculum training to ensure that staff understand key accounting concepts and the purpose of tasks.

Corrective Action Plan

The SCO has identified the following additional issues and corrective actions it will pursue based on our internal review of the CAFR process and discussions with SGR staff.

Issue—Internal and External Training

Currently, colleges focus on mainly public accounting. Consequently, there is a lack of expertise and knowledge in the application of governmental accounting and reporting standards, which makes it difficult for staff to understand and implement accounting and reporting standards and produce a CAFR.

Action: DAR will create core courses that all SGR staff must attend. The courses will include, but not be limited to, working paper preparation, CAFR preparation, new accounting and reporting standards, using SCO's GAAP system, and implementing quality assurance reviews.

For agencies, DAR will:

- Continue the annual open house and expand the effort with a focus on those agencies that submit incorrect statements and reports;

- Develop a series of classes on the implementation of new accounting and reporting standards;

- Create a presentation for State departments so that they understand the importance of submitting correct financial statements as well as the significance and magnitude of the CAFR on the State's ability to conduct business; and

- Explore with the California Department of Finance the possibility of increasing the number and frequency of State fund accounting courses being offered to State agencies as there currently is a long waiting list for classes.

Issue—Resources, including Classification and Compensation of Positions and Staff Retention

SGR accounting analysts are not paid commensurate with their duties and responsibilities, or at the level of similar State or county entities. In addition, SGR staff work excessive and prolonged overtime during the CAFR cycle. Consequently, SGR traditionally has had problems in recruiting and retaining staff members who possess knowledge and expertise in governmental accounting and the preparation of the CAFR.

Action: The SCO will continue to pursue with CalHR an SCO-specific accounting classification with compensation commensurate with the work performed. The SCO will also explore the option of using recruitment and retention bonuses.

Issue—Incorrect and Inconsistent Agency Submitted Data

As the SCO relies on agencies to provide valid, accurate documents and information, it is reasonable to expect that agencies submit correct financial statements and reports. The incorrect report submissions discussed above are not isolated incidents. The SCO tracks financial statement revisions and has determined that since the beginning of the decade, as displayed in the table below, there has been a marked increase (52 percent) in incorrect or inaccurate financial statements submitted to the SCO.

FISCAL YEAR		
2010–11	2011–12	2012–13
117	182	178

Not included in the tally in the table above were the numerous emails from State agencies requesting budgetary/legal and GAAP revisions to financial statements.

Submission of inaccurate or incorrect statements delays the start of the CAFR tasks and causes additional work to be performed; thereby, reducing the amount of time available for SCO staff to complete CAFR tasks.

Action: In addition to the above-mentioned training, DAR will follow up with the agencies that submit incorrect and inconsistent reports by performing site visits. Currently, Government Code Section 12461.2 allows the Controller to withhold the operating funds of an agency that submits late year-end financial reports. The SCO will explore the possibility of changing the Government Code to allow the Controller to withhold an agency or department director's salary until the financial statements are properly submitted.

Issue—Timing of Submission of Year-end Financial Reports

Currently fiscal year-end reports are due July 31 for the General Fund, feeder funds and Special Fund for Economic Uncertainties; August 20 for special funds; and October 1 for independently audited financial statements and GAAP adjustments. Late financial statement submissions impact the start of the annual CAFR cycle and may cause duplicate work to be performed. For fiscal year 2012–13, there were 111 financial statements submitted late, which impacted the start of the CAFR tasks.

Action: The SCO will contact the California Department of Finance to explore the possibility of changing the required due dates for the year-end reports. Beginning with the fiscal year 2013–14 report submissions, the SCO will post on the SCO website a list of the agencies that submit late reports.

Issue—Changing Bases of Accounting for Funds

For budgetary purposes, the State of California is moving further and further away from GAAP standards. Use of other than GAAP requires additional adjustments to the financial statements and creates the potential for misstatements.

Action: The SCO will explore the possibility of introducing new, or changing existing legislation, to adhere more closely to a GAAP-based standard.

Part Three

Federal Compliance Audit Report for the Year Ended June 30, 2013

STATE OF CALIFORNIA

Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2013

April 2014 Report 2013-002

Contents

Auditor’s Section

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 the Schedule of Expenditures of Federal Awards as Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

The Governor and the Legislature of the State of California:

Report on the Schedule of Expenditures of Federal Awards

We have audited the accompanying Schedule of Expenditures of Federal Awards (the Schedule) of the State of California for the year ended June 30, 2013.

Management's Responsibility for the Schedule of Expenditures of Federal Awards

Management is responsible for the preparation and fair presentation of the Schedule in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Schedule. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the Schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Schedule.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion

Opinion

In our opinion, the Schedule referred to above presents fairly, in all material respects, the expenditures of federal awards of the State of California, as of and for the year ended June 30, 2013, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As described in Note 1 to the Schedule, the State of California's financial statements include the operations of the University of California system, a component unit of the State of California, 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 Authority, a component unit of the State of California, which received $4.1 billion, $2.5 billion, $181.4 million, $116.4 million, and $64.1 million respectively, in federal awards which are not included in the Schedule for the year ended June 30, 2013. Our audit, described above, did not include the operations 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 because they have their own independent audits in compliance with OMB Circular A-133*, Audits of States, Local Governments, and Non-Profit Organizations.*

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated April 16, 2014 on our consideration of the State of California'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 of the Schedule, and the results of that testing, and not to provide an opinion on 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* in considering the State of California's internal control over financial reporting and compliance of the Schedule.

KPMG LLP

Sacramento, California
April 16, 2014

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 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, in accordance with the 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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the Schedule of Expenditures of Federal Awards (the Schedule) of the State of California as of and for the year ended June 30, 2013, and have issued our report thereon dated April 16, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the Schedule, we considered the State of California's internal control over financial reporting of the Schedule (internal control) to determine the audit procedures that are appropriate in the circumstances 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. 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 was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, 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 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 Schedule will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as 2013-001 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Schedule is free from 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

The State of California's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The State of California's response was not subjected to the auditing procedures applied in the audit of the Schedule and, accordingly, we express no opinion on the response.

Purpose of this Report

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* and in considering the State of California's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Sacramento, California
April 16, 2014

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 for Each Major Program and Report on Internal Control Over Compliance

The Governor and the Legislature of the State of California:

Report on Compliance for Each Major Federal Program

We have audited the State of California's compliance with the types of compliance requirements described in the *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, 2013. 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.

As described in Note 1 to the Schedule, the State of California's financial statements include the operations of the University of California system, a component unit of the State of California, 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, which received $4.1 billion, $2.5 billion, $181.4 million, $116.4 million, and $64.1 million, respectively, in federal awards which are not included in the schedule of expenditures of federal awards for the year ended June 30, 2013. Our audit, described below, did not include the operations 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 because they have their own independent audits in compliance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the State of California's major federal programs based on our audit of the types of compliance requirements referred to above. 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, *Audits of States, Local Governments, and Non-Profit Organizations*. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of the State of California's compliance.

Basis for Qualified Opinion on Major Federal Programs

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 regarding the following:

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT(S)	FEDERAL PROGRAM OR CLUSTER
Davis-Bacon Act			
	2013-022	California Department of Transportation	High-Speed Rail Corridors and Intercity Passenger Rail Services - Capital Assistance Grants (20.319) (ARRA)
Eligibility			
	2013-033	Department of Rehabilitation	Rehabilitation Services - Vocational Rehabilitation Grants to States (84.126)
Reporting			
	2013-024, 2013-025	California Department of Transportation	High-Speed Rail Corridors and Intercity Passenger Rail Services - Capital Assistance Grants (20.319) (ARRA)
Subrecipient Monitoring, Special Tests and Provisions			
	2013-002	Department of Social Services	SNAP Cluster
	2013-048	Department of Health Care Services	Block Grants for Community Mental Health (93.958)
Subrecipient Monitoring			
	2013-007	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
	2013-015	Board of State and Community Corrections	JAG Program Cluster
	2013-026	California Department of Transportation	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program) (20.509)
	2013-031	California Community Colleges Chancellor's Office	Career Technical Education - Basic Grants to States (Perkins IV) (84.048)
	2013-041	Department of Health Care Services	Medicaid Cluster
Special Tests and Provisions			
	2013-009	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
	2013-020	California Department of Transportation	Highway Planning and Construction Cluster (ARRA)

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

Qualified Opinion on Major Federal Programs

In our opinion, except for the noncompliance described in the first Basis for Qualified Opinion paragraph, the State of California complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the major federal programs listed in the Basis for Qualified Opinion paragraphs for the year ended June 30, 2013.

Unmodified Opinion on Each of the Other Major Federal Programs

In our opinion, the State of California complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the Table below and in the accompanying schedule of findings and questioned costs. Our opinion on each major federal program is not modified with respect to these matters.

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT(S)	FEDERAL PROGRAM OR CLUSTER
Activities Allowed/Allowable Costs			
	2013-049	Department of Health Care Services	Block Grants for Prevention and Treatment of Substance Abuse (93.959)
Cash Management			
	2013-046	Department of Public Health	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B) (93.917)
	2013-050	Department of Health Care Services	Block Grants for Prevention and Treatment of Substance Abuse (93.959)
Eligiblity			
	2013-005	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
Eligibility, Subrecipient Monitoring			
	2013-044	Department of Health Care Services	Medicaid Cluster
Matching, Level of Effort, Earmarking			
	2013-032	California Department of Education	Special Education Cluster (IDEA)
	2013-036	Department of Rehabilitation	Rehabilitation Services - Vocational Rehabilitation Grants to States (84.126)
Period of Availability			
	2013-037	California Department of Education	Charter Schools (84.282)
Procurement			
	2013-034	Department of Rehabilitation	Rehabilitation Services - Vocational Rehabilitation Grants to States (84.126)
Procurement, Subrecipient Monitoring			
	2013-003	California Department of Education	Child Nutrition Cluster
Suspension and Debarment, Special Tests and Provisions			
	2013-023	California Department of Transportation	High-Speed Rail Corridors and Intercity Passenger Rail Services - Capital Assistance Grants (20.319) (ARRA)
Reporting			
	2013-011	California Department of Education	Food Distribution Cluster
	2013-013	Department of Housing and Community Development	HOME Program (14.239)
	2013-018	Employment Development Department	WIA Cluster
	2013-027	California Department of Transportation	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program) (20.509)
	2013-029	California Department of Education	Title 1, Part A Cluster Food Distribution Cluster Migrant Education - State Grant Program (84.011) Special Education Cluster (IDEA) (ARRA) Charter Schools (84.282) School Improvement Grant Cluster Education Jobs (84.410) Child Nutrition Cluster Child Care and Development Fund Cluster
	2013-039	California Department of Education	School Improvement Grant Cluster (ARRA) Education Jobs Fund (84.410)
	2013-040	Department of Social Services	Foster Care Title IV-E (93.658) Adoption Assistance - Title IV-E (93.659) TANF Cluster”

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT(S)	FEDERAL PROGRAM OR CLUSTER
Reporting, Special Tests and Provisions			
	2013-030	California Department of Education	Migrant Education - State Grant Program (84.011)
Subrecipient Monitoring			
	2013-008	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
	2013-010	Department of Social Services, Department of Education	Food Distribution Cluster
	2013-012	Department of Housing and Community Development	HOME Investment Partnerships Program (14.239)
	2013-014	California Governor's Office of Emergency Services	JAG Program Cluster (ARRA)
	2013-016, 2013-017	Employment Development Department	WIA Cluster
	2013-045	Department of Health Care Services	Medicaid Cluster
	2013-047	Department of Public Health	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B) (93.917)

The State of California's responses to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The State of California's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the State of California is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the State of California's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and 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 a 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 2013-002, 2013-015, 2013-020, 2013-022, 2013-026, 2013-031, 2013-033, 2013-041, and 2013-048 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 2013-003, 2013-004, 2013-005, 2013-006, 2013-007, 2013-008, 2013-009, 2013-010, 2013-011, 2013-012, 2013-013, 2013-014, 2013-016, 2013-017, 2013-018, 2013-019, 2013-021, 2013-023, 2013-024, 2013-025, 2013-027, 2013-028, 2013-029, 2013-030, 2013-035, 2013-038, 2013-039, 2013-040, 2013-042, 2013-043, 2013-044, 2013-045, 2013-046, 2013-047, 2013-049, and 2013-050 to be significant deficiencies.

The State of California's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The State of California's responses were not subjected to the auditing procedures applied in the audit of compliance 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

Sacramento, California
April 16, 2014

Schedule of Findings and Questioned Costs

STATE OF CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Section I – Summary of Auditors' Results

Financial Statements

Issued under a separate cover. See California State Auditor's 2013-001.1 report entitled *State of California*: *Internal Control and State Compliance Audit Report for the Fiscal Year Ended June 30, 2013.*

Schedule of Expenditures of Federal Awards (Schedule)

Type of auditor's report issued	Unmodified
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 the Schedule 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 auditors' reports issued on compliance for major programs:	See below

Qualification

CFDA Number	Federal Program or Cluster
Various	SNAP Cluster
Various	JAG Program Cluster
Various	Highway Planning and Construction Cluster
Various	Medicaid Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
20.319	High-Speed Rail Corridors and Intercity Passenger Rail Services – Capital Assistance Grants
20.509	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program)
84.048	Career and Technical Education – Basic Grants to States (Perkins IV)
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States
93.958	Block Grants for Community Mental Health

Unmodified

CFDA Number	Federal Program or Cluster
Various	Food Distribution Cluster
Various	Child Nutrition Cluster
Various	WIA Cluster
Various	Title I, Part A Cluster
Various	Special Education Cluster (IDEA) (ARRA)
Various	School Improvement Grants Cluster
Various	CCDF Cluster
Various	TANF Cluster
14.239	Home Investment Partnerships Program
17.225	Unemployment Insurance
84.011	Migrant Education – State Grant Program
84.282	Charter Schools
84.410	Education Jobs Fund
93.268	Immunization Cooperative Agreements
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 (CHIP)
93.917	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B)
93.959	Block Grants for Prevention and Treatment of Substance Abuse

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	$114,253,853
Auditee qualified as low-risk auditee?	No

Identification of Major Programs

CFDA Number	Federal Program or Cluster
Various	SNAP Cluster
Various	Child Nutrition Cluster
Various	Food Distribution Cluster
Various	JAG Program Cluster (ARRA)
Various	WIA Cluster
Various	Highway Planning and Construction Cluster (ARRA)
Various	Title I, Part A Cluster
Various	Special Education Cluster (IDEA)
Various	School Improvement Grants Cluster (ARRA)
Various	TANF Cluster
Various	Child Care Development Fund (CCDF) Cluster
Various	Medicaid Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
14.239	Home Investment Partnership Program
17.225	Unemployment Insurance
20.319	High-Speed Rail Corridors and Intercity Passenger Rail Services – Capital Assistance Grants
20.509	Formula Grants for Other than Urbanized Areas
84.011	Migrant Education – State Grant Program
84.048	Career and Technical Education – Basic Grants to States (Perkins IV)
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States
84.282	Charter Schools
84.410	Education Jobs Fund
93.268	Immunization Cooperative Agreements
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 (Ryan White HIV/AIDS Program Part B)
93.958	Block Grants for Community Mental Health
93.959	Block Grants for Prevention and Treatment of Substance Abuse

Schedule of Expenditures of Federal Awards Findings and Questioned Costs

DEPARTMENT OF FINANCE AND OTHER DEPARTMENTS

Reference Number: 2013-001

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. SAM Section 7974 instructs departments to segregate American Recovery and Reinvestment Act (ARRA) expenditures from non-ARRA expenditures in instances where the same CFDA number is used.

Condition

The Department of Finance (Finance) and certain departments, as listed below, lack adequate controls to ensure the Schedule of Expenditures of Federal Awards (Schedule) and Report 13s are accurate. Finance did not have adequate review procedures over the Schedule, including an analytical review, that could have identified errors we found. The departments mentioned below did not have adequate review processes to ensure the accuracy of information submitted to Finance. 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 in the Schedule, which were corrected by Finance:

- Finance misclassified $67.2 million of expenditures as Research and Development for the Plant and Animal Disease, Pest Control, and Animal Care program.

- Finance did not cluster all Catalog of Federal Domestic Assistance (CFDA) numbers for the Food Distribution Cluster.

- Finance reported expenditures for the Section 8 Project-Based Cluster, the Capitalization Grants for Clean Water State Revolving Funds, and the Capitalization Grants for Drinking Water State Revolving Funds programs on the Schedule. However, these programs have separate OMB Circular A-133 audits and should not have been reported on the Schedule. Expenditures for these three programs were $291.5 million.

- Finance did not include the State Criminal Alien Assistance program, totaling $51.2 million on the Schedule.

- The California Department of Transportation (Caltrans) improperly identified $20.3 million of American Recovery and Reinvestment Act (ARRA) expenditures as non-ARRA on the Report 13 for the High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants.

- The California Department of Education (Education) improperly reported commodity noncash of $143.2 million under CFDA number 10.579 instead of 10.555.

- The Employment Development Department (EDD) improperly reported $8.6 billion of loans from the federal government on the Schedule that did not have continuing compliance requirements.

Department of Finance Recommendations

Finance should improve its review of the Schedule to identify and evaluate changes from the prior year. Specifically, Finance should perform of analytical procedures to identify programs that may be misclassified, missing, improperly included, or require additional analysis.

California Department of Transportation Recommendations

Caltrans should ensure it properly segregates ARRA expenditures on the Report 13.

California Department of Education Recommendations

Education should ensure it properly reports CFDA numbers for noncash expenditures.

Employment Development Department Recommendations

The EDD should review loan activity and report only those loans with continuing compliance requirements.

Department of Finance's View and Corrective Action Plan

We agree with this finding. Finance is aware of the importance of the reporting requirement. Finance is continuing to work on both a long-term and short-term solution to correct this finding.

In the short-term, Finance will inform state agencies/departments of the reporting and accounting errors made and stress the importance of submitting correct information. Finance will continue to work cooperatively with all state agencies/departments and provide additional guidance 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. Finance is developing an interim solution to automate the data collection process to reduce errors and improve data integrity.

In the long-term, the state 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. Upon completion of the FI$Cal Project, Finance will explore its capabilities to automate the Schedule compilation, thereby minimizing errors and inaccuracies.

Contact

Richard Sierra, Chief, Office of State Audits and Evaluations

Implementation Date

May 2014

California Department of Transportation's View and Corrective Action Plan

Caltrans agrees that the expenditures should have been reported as ARRA on the Report 13. Caltrans will review each project with the relevant Federal Catalog Number to ensure that ARRA projects are coded correctly to reflect ARRA expenditures. This review will be completed by March 15, 2014. Additionally, Caltrans will review procedures with staff in the impacted programs to ensure that federal project coding accurately reflects the federal program including ARRA funding.

Contact

Grace Kong, Chief, Office of Project Accounting

Implementation Date

March 15, 2014

California Department of Education's View and Corrective Action Plan

Education accepts the recommendation. Education received updated fiscal information late in the year which needed to be communicated to the Department of Finance for input to the Schedule of Expenditures of Federal Awards (SEFA). However, the updated information was inadvertently reported under the incorrect CFDA. To ensure reporting accuracy in the future, all revisions to the SEFA will be verified to the original accounting records and other supporting documentation.

Contact

Roxanne Eres, Director, Fiscal and Administrative Services Division

Mark Baude, Accounting Administrator III, Fiscal and Administrative Services Division

Implementation Date

March 2014

Employment Development Department's View and Corrective Action Plan

EDD concurs with the recommendation. The EDD will no longer provide information to the Department of Finance regarding EDD's federal loan for inclusion in the Single Audit's Schedule of Expenditures of Federal Awards (SEFA). The EDD has been notified that the type of federal loan reported on the SFY 2012-13 SEFA worksheet is not required in the said section. Therefore, beginning SFY 2013-14, the SEFA worksheet will only include the required information, per SAM, Section 7974.

Contact

Lydia Yowell, Accounting Administrator II – Financial Reporting and General Ledgers Group, Accounting Section, Administration Branch

Implementation Date

July 1, 2014

Schedule of Federal Award Findings and Questioned Costs

U.S. DEPARTMENT OF AGRICULTURE

Reference Number:	2013-002
Federal Catalog Number:	10.551
Federal Program Title:	Supplemental Nutrition Assitance Program (SNAP)
Federal Award Number and Year:	7CA400CA4; 2013 7CA420CAX; 2013 7CA4004CA; 2013 7CA4004CA; 2012 7CA430CA; 2012
Category of Finding:	Subrecipient Monitoring; Special Tests and Provisions
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)).

Condition

State automated welfare systems (SAWS) were implemented to manage various health and human services 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 eligibility, reporting SNAP benefits issued, and distributing, securing, and accounting for certain EBT cards.

During our audit for fiscal year 2011-12, we identified that 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 in terms of how certain federal compliance requirements related to the SAWS and EBT cards were to be addressed in the county OMB Circular A-133 audits. Social Services issued an All County Welfare Directors Letter in June 2013 notifying county welfare departments of their responsibilities for complying with federal regulations related to monitoring the SAWS and for ensuring EBT card security; however, this letter did not communicate that these requirements should be covered in a county OMB Circular A-133 audit.

As result of SEFA reporting, review of prior year county OMB Circular A-133 audits, and discussions with Social Services, we concluded the special tests related to the SAWS, reporting, and special tests related to EBT cards may not be subject to audit. These requirements are not subject to audit at the state level since the SAWS are county-owned systems. During our audit, we noted that Social Services has implemented various quality control processes and procedures to ensure compliance with federal requirements. However, certain compliance requirements are not currently subject to audit by an independent auditor as required by OMB Circular A-133.

With county-owned systems, we concluded that all SNAP expenditures must be reported on the county's Schedule of Expenditures of Federal Awards (SEFA) in order for applicable SNAP compliance requirements to be subject to testing in an OMB Circular A-133 audit. SNAP EBT benefits are not reported on the county SEFA based on guidance provided in the OMB Circular A-133 Compliance Supplement which states the following:

> "A county should not be reporting expenditures for SNAP benefits in its SEFA or in its SF-SAC. This is because SNAP benefits are provided exclusively by EBT. In an EBT environment, there is no pass-through of Federal funds for SNAP benefits. Rather, benefits are processed and expenditures determined by State-level EBT systems. With respect to counties, therefore, SNAP benefits do not meet the definitions of "Federal award" and "Federal financial assistance" set out in OMB Circular A-133, section __.105."

Questioned Costs

No specific questioned costs were identified.

Recommendations

Social Services should work with the U.S. Department of Agriculture (USDA) to determine how applicable SNAP compliance requirements are covered in county OMB Circular A-133 audits. If Social Services determines that SNAP EBT benefits should not be reported in the county SEFA, but be subject to audit at the county, it should obtain approval of its determination in writing from USDA.

Department's View and Corrective Action Plan

The California Department of Social Services (CDSS) acknowledges that the audit requirement currently is not independently performed. California's fifty-eight county welfare departments (CWDs) rely primarily on three eligibility and case management systems, namely CalWIN, C-IV, and LEADER (known as the SAWS consortia) to assist in the determination of CalFresh eligibility and benefit calculations. We will be consulting with the SAWS consortia systems as to whether this requirement reasonably can be added to the scope of their existing independent audit activities, and thus comply with the United States Department of Agriculture (USDA) requirement without having 58 counties individually and redundantly conduct testing on the same three SAWS consortia systems. Currently however, we note that from initial client applications through recertifications, these automated systems originally underwent rigorous testing of their functionality and accuracy prior to implementation, and they continue to undergo testing prior and subsequent to implementation of policy changes. As required by the USDA, Food and Nutrition Service (USDA-FNS), the CDSS annually performs extensive CalFresh management evaluations to identify areas of non-compliance and quality control activities to ensure CalFresh payment accuracy and timeliness. California's statewide SNAP payment error rates have been steadily improving from 6.98% in FFY 2006 to 2.96% in FFY 2013. In addition, California has robust engagement with stakeholders and responds quickly whenever a client raises a concern about eligibility or benefits, which bolsters our confidence in the appropriateness and accuracy of the SAWS consortia systems' output.

Contact

Sysvanh Kabkeo, Chief, CalFresh Management Operations Section

Implementation Date

Discussions with the SAWS consortia will occur soon, and an update will be provided in the next periodic audit response update.

Auditors' Conclusion

We acknowledge that Social Services has means to assess the compliance requirements referenced above and the SAWS go through testing. However, as Social Services has noted, the compliance requirements are not subject to independent audit, either by the state or county auditor. Social Services should work with USDA to determine if Social Services' monitoring is sufficient to address the compliance requirements given the relationship between the Federal government, State, and counties.

Reference Number:	2013-003
Federal Catalog Number:	10.553, 10.555
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Year:	7CA300CA3; 2013 7CA300CA3; 2012 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

During our audit for fiscal year 2011-12, we reported that Education did not fully implement adequate controls to ensure that it documented approval of food service management company contracts within the Child Nutrition Information and Payment System (CNIPS) prior to reimbursing subrecipients. Although the School Food Service Contracts Unit was created to ensure compliance with federal requirements, the unit was not able to review 16 of 38 contracts for fiscal year 2012-13. Education's failure to properly approve food service contracts increases the risk that such contracts may not comply with federal regulations.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should fully implement its process to review food service management company contracts to ensure compliance with federal procurement requirements

Department's View and Corrective Action Plan

Education accepts the recommendation. To ensure compliance with federal requirements prior to subrecipients' application renewal and reimbursement of federal funds, Education's School Food Service Contracts Unit (SFSCU) reviews and approves food service management company contracts submitted to Education; SFSCU approvals are documented in CNIPS to allow the disbursement of nutrition program funds to subrecipients.

The SFSCU:

- Reviewed 83 FSMC contracts and contract extensions for the 2013–14 school year
- Required SFAs that are operating under extensions of their original FSMC contract to correct problems identified in their original procurement process through amendments to their current extension requests
- Assisted the School Nutrition Programs Unit (SNPU) with their annual updates in CNIPS, which helped educate SFSCU staff on SFA CNIPS application protocols, school meal program requirements, and CNIPS FSMC protocols
- Improved Education's Food Service Management Procurement Web page
- Developed a sample FSMC Request for Proposal (RFP) and model Contract, and:
    - » Held a stakeholder meeting in December 2013 with FSMC representatives and Education staff to review the draft sample FSMC RFP and model contract
    - » Posted the sample FSMC RFP and model Contract in December 2013 to Education's Food Service Management Procurement Web page
    - » Incorporated feedback from FSMC Representatives, public school districts, and the USDA and will post the revised sample RFP and model Contract in February 2014
- Created a Microsoft Excel contract tracking system to identify and notify SFAs that are due to rebid their contracts and to track review activities to ensure that both Education and SFAs are being responsive to the established review timeline
- Submitted a CNIPS change request (CR) to improve functionality of the CNIPS FSMC Fact Sheet to better track the contract approval process (Note: CR is estimated to be implemented in 2015)
- Completed the week-long U.S. Department of Agriculture (USDA) Administrative Review Training in San Francisco (SFSCU Manager only)
- Completed online National Food Service Management Institute State Agency Guidance procurement training (SFSCU Manager and staff)

The SFSCU is currently:

- Reviewing and approving all procurement documents, including contracts, for FSMC contract rebids for the 2014–15 school year
- Reviewing and approving FSMC contract extensions for the 2014–15 school year
- Customizing the current Sample Fixed-Fee RFP and Contract
- Developing a Sample Cost-Reimbursable RFP and Contract
- Conducting weekly staff meetings to discuss contract review status, issues, and projects
- Developing Webinars to educate SFAs on procurement laws and regulations and Education's FSMC contract review and approval process (first Webinar scheduled for May 2014)
- Participating in the new USDA Administrative Review Task Force to develop State Agency SFA/FSMC oversight procedures

Contact

Sandip Kaur, Division Director, Nutrition Services Division,
Chris Kavooras, School Nutrition Programs Administration Manager, Nutrition Services Division

Implementation Date

April 2013 – February 2014

Reference Number:	2013-004
Federal Catalog Number:	10.553, 10.555
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Year:	7CA300CA3; 2013 7CA300CA3; 2012 7CA300CA3; 2011
Category of Finding:	Reporting; Subrecipient Monitoring
Type of Finding:	Significant Deficiency
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.

State Administrative Manual, Section 5300 – Information security refers to the protection of information, information systems, equipment, software 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, optical, oral, print, or other media) is critical to ensure business continuity, and protect information assets against unauthorized access, use, disclosure, disruption, modification, or destruction. Information security is also the means by which privacy of personal information held by state entities is protected.

State Administrative Manual, Section 5365 – Each state entity shall establish and implement physical security and environmental protection controls to safeguard information assets against unauthorized access, use, disclosure, disruption, modification, or destruction.

Condition

The information technology controls over logical access on the Education Child Nutrition Information and Payment System (CNIPS) were not properly designed or implemented. Education uses CNIPS to calculate reimbursements to subrecipients based on approved rates and meal counts. During our audit, we noted the following:

- Five of five users tested had access granted by an unauthorized approver.

- Seven of 273 state users with access to CNIPS were individuals no longer employed with Education.

- User access reviews are not being consistently performed. The most recent review performed was in fiscal year 2011-12 and was based off of an organization chart/Microsoft Outlook listing rather than a separation listing obtained from human resources.

- A process for identifying potential segregation of duties conflicts on the CNIPS application level is not in place. We found two groups with the ability to approve the creation of a site and sponsor, approve the submission of a claim, and move the claim to a claim tracking status. We also found one user who had a state and local account.

Failure to maintain adequate information technology controls over logical access could result in improper reimbursements from the Federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should strengthen CNIPS information technology controls over logical access. Specifically, Education should:

1. Implement a process to ensure user access is granted by authorized approvers.

2. Implement a process to ensure employees no longer employed with Education are deactivated timely.

3. Implement periodic reviews of user access using a separation listing from human resources.

4. Implement a process for identifying potential segregation of duties conflicts within the application and ensure users cannot have a state and local account.

Department's View and Corrective Action Plan

California Department of Education's (CDE) Response to Recommendation No. 1:

- The CDE accepts the recommendation. The CDE will review the access logs for CNIPS and delete all obsolete and unauthorized employees; access will only be granted by authorized approvers.

CDE's Response to Recommendation No. 2:

- The CDE accepts the recommendation. The CDE will strengthen existing procedures to ensure that retired or other departed employees that no longer have CNIPS-related responsibilities be timely deactivated.

CDE's Response to Recommendation No. 3:

- The CDE accepts the recommendation. The CDE will conduct quarterly periodic reviews of user access to ensure that only existing authorized users have access to CNIPS.

CDE's Response to Recommendation No. 5:

- The CDE accepts the recommendation. The CDE will reassess staff duties and segregate key duties in conflict amongst appropriate staff.

Contact

Michele Vasquez, Program Integrity Unit Manager, Nutrition Services Division

Implementation Date

June 30, 2014

Reference Number:	2013-005
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2013 7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012
Category of Finding:	Eligibility
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

Criteria

Title 7: Agriculture, PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN, Subpart C—Participant Eligibility, § 246.7 Certification of participants.

(c) *Eligibility criteria and basic certification procedures*. (1) To qualify for the Program, infants, children, and pregnant, postpartum, and breastfeeding women must:

(i) Reside within the jurisdiction of the State (except for Indian State agencies). Indian State agencies may establish a similar requirement. All State agencies may determine a service area for any local agency, and may require that an applicant reside within the service area. However, the State agency may not use length of residency as an eligibility requirement.

(ii) Meet the income criteria specified in paragraph (d) of this section.

(d) *Income criteria and income eligibility determinations.* The State agency shall establish, and provide local agencies with, income guidelines, definitions, and procedures to be used in determining an applicant's income eligibility for the Program.

(o) *Are applicants required to be physically present at certification?* — (1) In general. The State or local agency must require all applicants to be physically present at each WIC certification.

Condition

Local agencies did not have adequate policies and procedures to ensure income and other eligibility criteria were evidenced in accordance with state and federal requirements. Local agencies are responsible for eligibility determination for participants in the WIC program using the Integrated Statewide Information System (ISIS).

We tested 65 beneficiaries and found three cases in which required eligibility information was not obtained or evidenced in ISIS. As a result, we could not conclude the participants were eligible to receive $2,211 in benefits.

- For one case, the participant provided no income documentation when the child was certified; and the local agency did not place the required hold on the case until appropriate documentation was received.

- For one case, the local agency noted an infant less than eight weeks old was not present at enrollment. The local agency did not place a hold on the case and there was no evidence the infant was present at the next appointment or within eight weeks to meet the present at certification requirement.

- For one case, the local agency did not provide supporting eligibility information.

Total federal expenditures to participants for food instruments amounted to $797,167,300 for fiscal year 2012-13. Total benefits paid to the 65 tested participants amounted to $38,158.

Questioned Costs

$2,211

Recommendations

Public Health should strengthen its communication and training to local agencies to ensure intake workers responsible for eligibility determination are knowledgeable of the documentation requirements in ISIS.

Department's View and Corrective Action Plan

The California Department of Public Health (CDPH) agrees with this recommendation and has fully implemented it.

The WIC Program has procedures in place to monitor and evaluate the local agencies' (LAs) compliance with eligibility requirements and documentation policies. CDPH contract monitors evaluate the LAs for compliance as required by federal and state regulations and provide ongoing training and technical assistance. If a finding occurs during a contract monitoring review or audit, the LAs must complete a corrective action plan and the WIC Program monitors to ensure the LA resolves the finding and implements the corrective action plan.

The WIC Program has contacted the LAs to provide additional technical assistance in the areas identified in the audit findings. In two of the cases, the certification period was already over, but the WIC Program was able to verify with the LA that it made the corrections during the certification period. In the case of the infant not present during the first eight weeks, the LA stated that the infant was a high-risk premature infant and unable to be present during the first eight weeks. The WIC Program Manual 210-07 (10.557-2 Attachment C) allows an exemption from the presence at certification requirement for this type of situation.

Additionally, WIC Program staff provides ongoing technical assistance to ensure LAs successfully resolve any finding and continue compliance.

Contact

Lisa Kawano, Acting WIC Division Chief

Implementation Date

On October 16, 2013, the WIC Program spoke with the local agencies regarding the findings and provided technical assistance. In addition, at the December 10, 2013 monthly WIC Director's teleconference, the WIC Program provided further clarification and guidance in the area of certification.

Reference Number:	2013-006
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2013 7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012
Category of Finding:	Eligibility; Special Tests and Provisions
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Public Health (Public Health)

Criteria

State Administrative Manual, Section 5300 – Information security refers to the protection of information, information systems, equipment, software 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, optical, oral, print, or other media) is critical to ensure business continuity, and protect information assets against unauthorized access, use, disclosure, disruption, modification, or destruction. Information security is also the means by which privacy of personal information held by state entities is protected.

State Administrative Manual, Section 5365 – Each state entity shall establish and implement physical security and environmental protection controls to safeguard information assets against unauthorized access, use, disclosure, disruption, modification, or destruction

TITLE 7 – AGRICULTURE, SUBTITLE B – REGULATIONS OF THE DEPARTMENT OF AGRICULTURE, CHAPTER II – FOOD AND NUTRITION SERVICE, DEPARTMENT OF AGRICULTURE, PART 246, SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN, SUBPART E - STATE AGENCY PROVISIONS, Section 12 – Food Delivery Systems:

(g) Retail Food delivery systems: Vendor authorization –

> (4) Vendor selection criteria: competitive price. The State agency must establish a vendor peer group system and distinct competitive price criteria and allowable reimbursement levels for each peer group. The State agency must use the competitive price criteria to evaluate the prices a vendor applicant charges for supplemental foods as compared to the prices charged by other vendor applicants and authorized vendors, and must authorize vendors selected from among those that offer the program the most competitive prices. The State agency must consider a vendor applicant's shelf prices or the prices it bids for supplemental foods, which may not exceed its shelf prices. In establishing competitive price criteria and allowable reimbursement levels, the State agency must consider participant access by geographic area. The State agency must inform all vendors of the criteria for peer groups, and must inform each individual vendor of its peer group assignment.

(i) Vendors that meet the above-50-percent criterion:

(D) Must ensure that the prices of above-50-percent vendors do not inflate the competitive price criteria and allowable reimbursement levels for the peer groups or result in higher total food costs if program participants transact their food instruments at above-50-percent vendors rather than at other vendors that do not meet the above-50-percent criterion. To comply with this requirement, the State agency must compare the average cost of each type of food instrument redeemed by above-50-percent vendors against the average cost of the same type of food instrument redeemed by regular vendors. The average cost per food instrument may be weighted to reflect the relative proportion of food instruments redeemed by each category of vendors in the peer group system. The State agency must compute statewide average costs per food instrument at least quarterly to monitor compliance with this requirement. If average payments per food instrument for above-50-percent vendors exceed average payments per food instrument to regular vendors, then the State agency must take necessary action to ensure compliance, such as adjusting payment levels. Where EBT systems are in use, it may be more appropriate to compare prices of individual WIC food items to ensure that average payments to above-50-percent vendors do not exceed average payments for the same food item to comparable vendors. If Food and Nutrition Service (FNS) determines that a State agency has failed to ensure that above-50-percent vendors do not result in higher costs to the program than if participants transact their food instruments at regular vendors, FNS will establish a claim against the State agency to recover excess food funds expended and will require remedial action. A State agency may exclude partially redeemed food instruments from a quarterly cost neutrality assessment based on an empirical methodology approved by FNS. A State agency may not exclude food instruments from the quarterly cost neutrality assessment based on a rate of partially redeemed food instruments.

Condition

During our audit for fiscal year 2011-12, we reported the information technology (IT) controls over logical access and change management for the Integrated Statewide Information System (ISIS) were not properly designed. In fiscal year 2012-13, we also found certain information technology controls over logical access were not properly designed and implemented. Public Health utilizes ISIS to determine eligibility for WIC participants and monitor issuance and redemption of food vouchers. IT general controls should be properly designed and operating effectively to help ensure application controls function properly.

Public Health did not properly terminate access to ISIS. We found that 16 of the 292 individuals with access to ISIS had been terminated and, therefore, should no longer have access to the system. In addition, Public Health did not properly restrict access for one of 25 users tested. Public Health granted the user access to the policy/eligibility functions within ISIS: however, the user's job function did not require this level of access. We also noted that it does not have a control in place to annually review the level of access granted to users.

Additionally, we found that the cost neutrality report generated from ISIS appears to be double counting certain food instruments. The cost neutrality report is used to perform the quarterly cost neutrality assessment, to ensure that the average price per food instruments type that above-50-percent vendors charge participants does not exceed the price charged by regular vendors, either within their peer groups or statewide. The cost neutrality report for each quarter was between 50 and 83 food instruments higher than the query used to identify the number of food instruments for regular vendors.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Public Health should improve its policies and procedures over terminating user access and granting and reviewing the appropriate level of user access. Additionally, Public Health should ensure that the cost neutrality report accurately reports the number of food instruments for regular vendors.

Department's View and Corrective Action Plan

CDPH agrees with this recommendation and has partially implemented it.

CDPH relies on local agencies (LAs) to comply with CDPH policy to ensure the security and integrity of the ISIS system. This policy requires LA supervisors to "review the agency's ISIS logon ID Maintenance Report" and delete any logon IDs of former employees and any other unnecessary logon IDs in accordance with the California WIC Program Manual. CDPH's Information Technology Services Division (ITSD) generates the ISIS logon ID Maintenance Report, which the WIC Program distributes monthly to LAs.

By August 31, 2014, the WIC Program will clarify instructions and expectations for use of the "ISIS logon ID Maintenance Report" and include reference to WIC 140-20 when distributing the report to the LAs.

By August 31, 2014, the WIC Program and ITSD will develop a role-based ISIS ID request/change form that defines the minimum ISIS access requirements to align with the application needs of employees. The WIC Program will continue to require three levels of signatures before any ISIS ID changes are made.

Regarding the appearance that the cost neutrality report generated from ISIS may have been double counting certain food instruments, ITSD and WIC worked together to analyze the detailed SQL parameters to confirm that the SQL used to produce the cost neutrality report from ISIS is not double counting any records. As of March 10, 2014, the WIC Program and ITSD confirmed that the SQL parameters contain no errors and ISIS is no longer double counting any food instruments.

Contact

Edwin Lieu, Data Processing Manager III, ITSD

Implementation Date

August 31, 2014

Reference Number:	2013-007
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2013 7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Material Instance of Noncompliance

State Administering Department:	Department of Public Health (Public Health)

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

Public Health did not perform financial management reviews required by the approved State Plan for six of 84 subrecipients during the last two years. Subrecipients perform eligibility determinations, as well as distribute food instruments to beneficiaries. In addition, Public Health did not have adequate controls in place to ensure notices of audit findings were issued within 90 days of completion of the financial management review. We tested 13 financial management reviews performed in fiscal year 2012-13 and found that nine had findings which required issuance of a notice of audit findings to the subrecipient. However, Public Health did not issue the notice of audit finding for any of the nine reviews. Public Health informed us that its legal department issued a hold on issuing notices of audit finding letters to subrecipients until the document could be reviewed by legal in January 2013. Upon review, no changes were made to the notice of audit finding letters, and the hold was lifted in August of 2013. Failure to conduct required financial management reviews and issue audit finding letters increases the risk that subrecipients are utilizing federal funds for unallowable costs and activities.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Public Health should ensure that all subrecipients have a financial management review performed at least once every two years in accordance with federal regulations. Public Health should also improve its policies and procedures to ensure that notices of audit findings are issued within 90 days of completion of a financial management review.

Department's View and Corrective Action Plan

CDPH agrees with the recommendation and has partially implemented it.

The State Controller's Office (SCO) conducts subrecipient financial management reviews for CDPH via an Interagency Agreement (IAA). During the audit review period, SCO experienced a shortage of qualified audit staff. This shortage resulted in 6 of 84 reviews not completed. As soon as staff resources were available, SCO completed the six reviews identified in this finding and issued the following reports:

Glenn County – Agency No. 237:	Report Issued 08/28/2013
Tulare County – Agency No. 218:	Report Issued 08/28/2013
Siskiyou County – Agency No. 224:	Report Issued 08/30/2013
Mendocino County – Agency No. 115:	Report Issued 10/08/2013
Trinity County – Agency No. 236:	Report Issued 11/08/2013
Sonoma County Indian Health – Agency No. 127	Report Issued 12/19/2013

SCO is currently fully staffed to perform subrecipient financial management reviews within the required timelines. CDPH closely monitors SCO's performance and deliverables to ensure ongoing compliance with the terms of the IAA.

During the audit period, SCO identified significant issues in several subrecipient financial management reviews. In addition, CDPH Office of Legal Services reviewed the regulations related to subrecipient monitoring. These two activities delayed the WIC Program's issuance of demand letters to subrecipients. On August 14, 2013, the WIC Program resumed timely issuance of the Notice of Audit Findings (NAFs).

Below is the status of the NAFs the finding identified as not issued:

Humboldt County	Due: 04/30/2013	Status: Issued 08/13/2013
City of Berkeley	Due: 02/27/2013	Status: Issued 08/14/2013
Gardner Family Health	Due: 03/04/2013	Status: Issued 09/25/2013
Contra Costa Health	Due: 08/21/2013	Status: Issued 09/30/2013
Toiyabe Indian Health	Due: 02/11/2013	Status: Issued 09/30/2013
Community Bridges	Due: 11/26/2012	Status: Issued 02/14/2014

The three NAFs listed below as pending will be issued by March 31, 2014.

L A BioMedical Research	Due: 01/08/2013	Status: Pending
Santa Barbara County	Due: 12/27/2012	Status: Pending
Riverside County	Due: 01/10/2013	Status: Pending

Contact

Lisa Kawano, Acting WIC Division Chief

Implementation Date

CDPH will issue the NAFs by March 31, 2014.

Reference Number:	2013-008
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2013 7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – A*UDITS 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

Public Health did not properly monitor its contract with the State Controllers' Office (SCO) to ensure it issued management decisions letters in accordance with the timelines outlined in the contract. Public Health contracts with the SCO to review subrecipient OMB Circular A-133 reports and issue management decisions on audit findings for the WIC program. The SCO reviewed 84 OMB Circular A-133 reports and noted four had findings related to the WIC program. However, the SCO did not issue a management decision letter within six months of receipt of the subrecipient's audit report for two of those four reports. Failure to properly follow up on audit findings increases the risk that subrecipients may inappropriately use federal funds or grant benefits to ineligible participants.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Public Health should strengthen its policies and procedures to ensure that it issues management decision letters on audit findings within six months after receipt of a subrecipient's audit report.

Department's View and Corrective Action Plan

CDPH agrees with this recommendation and has partially implemented it.

CDPH did not issue management decision letters within six months of receipt of the A-133 audit report for two subrecipients. Due to clerical oversight WIC was unaware of the finding for the County of Ventura as well as City of Long Beach and management letters were not issued. CDPH will obtain the A-133 reports, review them, and issue a management decision letter.

To ensure timely issuance of decision letters, CDPH will amend its IAA with SCO. The WIC Program, not SCO, currently reviews the A-133 audit reports and issues management decision letters. However, the IAA does not properly describe relative roles and responsibilities. CDPH will amend the IAA to reflect SCO's responsibility to ensure that A-133 reports from private non-profit (PNP) subrecipients conform to federal requirements. In addition, the amendment will reflect SCO's responsibility to timely notify CDPH of any finding in a PNP's A-133 audit that affects the WIC program.

Contact

Lisa Kawano, Acting WIC Division Chief

Implementation Date

CDPH will issue the management decision letters by March 31, 2014.

CDPH will amend the IAA with SCO by October 31, 2014.

Reference Number:	2013-009
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2013 7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012
Category of Finding:	Special Tests and Provisions
Type of Finding:	Significant Deficiency and Material Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

Criteria

Title 7: Agriculture, PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN, Subpart E—State Agency Provisions, § 246.12 Food delivery systems.

(k) Retail food delivery systems: Vendor claims

(4) Time frame and offset. The State agency must deny payment or initiate claims collection action within 90 days of either the date of detection of the vendor violation or the completion of the review or investigation giving rise to the claim, whichever is later. Claims collection action may include offset against current and subsequent amounts owed to the vendor.

Condition

Public Health did not have adequate controls in place to ensure it took appropriate action on findings identified during vendor inventory audits. In fiscal year 2012-13, Public Health conducted 190 vendor inventory audits. However, Public Health did not issue notice of audit findings within 90 days of completion of the audit for four of 40 compliance investigations tested. As of June 30, 2013, two of the notice of audit finding letters had been issued to vendors and the collection process had begun. However, two of the notice of audit finding letters had not been issued and a total of $112,238 in vendor claims collections had not been initiated. Public Health informed us that its legal department issued a hold on issuing notices of audit finding letters to subrecipients until the document could be reviewed by legal in January 2013. Upon review, no changes were made to the notice of audit finding letters, and the hold was lifted in August of 2013. Failure to issue notices of audit findings on compliance investigations increases the risk that vendors inappropriately redeem food instruments and the state will not reclaim monies owed.

Questioned Costs

$112,238

Recommendations

Public Health should implement its policies and procedures over vendor inventory audits which require notice of audit findings to be issued within 90 days of completion of the audit in order to initiate the claims collection process.

Department's View and Corrective Action Plan

CDPH agrees with this recommendation and has partially implemented it.

CDPH issued the four Notice of Audit Findings identified by the auditor as missing, on the following dates:

#322617	VALUE + EXPRESS MARKET:	Report Issued: 01/31/2014
#148545	LA PRINCESA MARKET #9:	Report Issued: 01/15/2013
#312756	EL SOL MARKET:	Report Issued: 01/24/2014
#364571	CARDENAS MARKET #1:	Report Issued: 01/16/2013

The WIC Program is developing policies and procedures for vendor inventory audits to ensure audit findings are issued within 90 days of completion of the audit in order to initiate the claims collection process. The WIC Program will finalize the policies and procedures by February 28, 2014.

Contact

Lisa Kawano, Acting WIC Division Chief

Implementation Date

The WIC Program issued the four Notice of Audit Findings identified by the auditor on the dates noted above.

The WIC Program will finalize new policies and procedures by April 30, 2014.

Reference Number:	2013-010
Federal Catalog Number:	10.565, 10.568, 10.569
Federal Program Title:	Food Distribution Cluster
Federal Award Number and Year:	7CA400CA2; 2013 7CA400CA2; 2012 7CA810CA1; 2013 7CA810CA1; 2012
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Social Services (Social Services); 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 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.

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

Social Services and Education do not have adequate policies and procedures in place to monitor subrecipients in accordance with federal requirements. Both departments administer the Food Distribution Cluster through Eligible Recipient Agencies (ERA) and local agencies. Our audit found the following:

- Education did not obtain DUNS numbers for awards made during fiscal year 2012-13. Failure to obtain DUNS numbers increases the risk that subawards may be incorrectly reported.

- Social Services did not properly monitor and follow-up on audit findings identified in ERA OMB Circular A-133 audits. Failure to properly follow-up on audit findings increases the risk that ERA may inappropriately use federal funds or provide food commodities to ineligible participants. Social Services instructs ERA to submit OMB Circular A-133 audits and performs a limited review; however, it did not obtain corrective action plans and issue management decision letters within six months of receipt of the ERA's audit report.

Social Services passed through $8.6 million in cash and $87.8 million in food commodities to ERA during fiscal year 2012-13. Education passed through $4.5 million in cash and $21.3 million in food commodities to local agencies during fiscal year 2012-13.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Social Services and Education should strengthen policies and procedures to ensure that they properly monitor subrecipients. Specifically:

1. Education should obtain DUNS numbers from local agencies.

2. Social Services should ensure that corrective action plans are obtained and management decision letters are issued for audit findings within six months after receipt of an ERA's audit report.

Department of Social Services' View and Corrective Action Plan

CDSS agrees with this finding. CDSS will implement procedures to ensure the ERA audit reports that contain findings will be addressed through the management decision letter and corrective action plan process. The target date is July 1, 2014.

Contact

Sabrina Sassman, Chief, Welfare Fraud and Emergency Food Assistance Bureau

Implementation Date

July 1, 2014

California Department of Education's View and Corrective Action Plan

Education accepts the recommendation. Education has strengthened policies and procedures to require that DUNS numbers are obtained for all Commodity Supplemental Food Program (CSFP) agency participants. Currently, Education has DUNS numbers for all six CSFP participating agencies.

Contact

Stephanie Ewing, RD, Manager, Distribution and Processing Unit, Nutrition Services Division

Implementation Date

December 2013

Reference Number:	2013-011
Federal Catalog Number:	10.565
Federal Program Title:	Food Distribution Cluster
Federal Award Number and Year:	7CA400CA2; 2013 7CA400CA2; 2012 7CA810CA1; 2013 7CA810CA1; 2012
Category of Finding:	Reporting
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 – A*UDITS 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.

Food and Nutrition Service (FNS)-153, *Monthly Report of the Commodity Supplemental Food Program and Quarterly Administrative Financial Status Report* (OMB No. 0584-0293) – This report requests the number of CSFP participants in each category (women, infants, children, and elderly), the receipt and distribution of USDA foods, and beginning and ending inventories, as well as other foods data; and on a quarterly basis, the cumulative amount of administrative funds expended and obligated, and the amounts remaining unobligated.

Condition

Education does not have adequate controls in place to ensure accuracy of FNS-153 reports submitted for the Food Distribution Cluster, including reconciliation to supporting documents. Education did not accurately report outlays or unliquidated obligations for one of two FNS-153 reports tested, resulting in a net understatement of $4,207,970 of federal expenditures. Failure to reconcile reports to supporting documents increases the risk of errors in information reported to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should strengthen its process over reconciliation and review of FNS-153 reports to ensure accuracy of the reports prior to submission.

Department's View and Corrective Action Plan

Education accepts the recommendation. To ensure the accuracy of Food and Nutrition Service (FNS)-153 reports, Education's controls include the following data review and validation procedures:

- The Local Agency reports are combined into a single state report by two CSFP staff members; one staff reviews the inventory information, another staff validates the participation information.

- Once confirmed, the data is manually entered into the Food Programs Reporting System (FPRS). Upon the initial submission, the FPRS conducts a data error check and produces an Engine Validation report which identifies key data errors and warnings of possible reporting data errors. The errors are corrected, the warnings considered, and the Engine Validation report is run again to ensure the correction of all errors.

- Copies of the FNS-153 reports and all backup documentation are submitted to the Commodity Supplemental Food Program (CSFP) Manager for final review and approval. The CSFP Manager certifies the FNS-153 report submission in the FPRS and sends an e-mail to the USDA to confirm the review and certification.

- After the FNS-153 reports are submitted to the USDA, the USDA confirms via e-mail on the sufficiency and acceptance of the reports.

The primary purpose of the FNS-153 report is to report the monthly CSFP participation, inventory levels, and funding to the USDA. The FNS-153 informs the USDA of the amount of CSFP funding released to the Local Agencies, and the amount of funding that is expected to be released for the remainder of the reporting period. The CSFP funding must be fully expended and reported to the USDA by December 30 following the end of the federal fiscal year; any unexpended funds are reverted back to the USDA. Since the USDA already has the total annual CSFP funding amounts, the key reporting FNS-153 data fields are the “Outlays” and ”Unliquidated Obligations,” not the “Unliquidated Balances of Advances.”

The error that the auditors cite in the condition was a misreporting of “Unliquidated Balances of Advances” on Education’s December 2012 FNS-153 report. However, on January 31, 2013, the USDA confirmed via email that Education’s FNS-153 report was fine and posted. On March 18, 2013, at Education’s request, the USDA sent Education the following message: “This confirms and reiterates that your December 2012 FNS-153 report submission was fine. There were no questions or comments from our WRO (Western Region Office) program staff or from our Headquarters Office regarding this report.”

Contact

Stephanie Ewing, RD, Manager, Distribution and Processing Unit, Nutrition Services Division

Implementation Date

Current Process

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Reference Number:	2013-012
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME)
Federal Award Number and Year:	M12-SG060100; 2013
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Housing and Community Development (HCD)

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

During our audit for fiscal year 2011-12, we reported that HCD did not have a process in place to obtain DUNS numbers from its HOME program subrecipients prior to awarding federal funds. In fiscal year 2012-13, HCD updated its 2013 Notice of Funding Availability (NOFA) that will require subrecipients to submit DUNS numbers during the application process. However, the HOME program's 2012 NOFA, which was in place during fiscal year 2012-13, did not contain a request for subrecipients to provide DUNS numbers, and HCD did not implement another process to obtain DUNS numbers from subrecipients in fiscal year 2012-13. Failure to obtain DUNS numbers prior to awarding HOME program funds increases the risk that HCD may not properly report subawards to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

HCD should follow the process implemented for its 2013 NOFA to obtain DUNS numbers from HOME program subrecipients prior to making the subaward.

Department's View and Corrective Action Plan

HCD agrees with the finding. In 2013, HCD established a process for all future Notice of Funding Availability (NOFA) beginning with the 2013 NOFA that require subrecipients to submit DUNS numbers during the application process. The Department will continue to follow the process implemented for our 2013 NOFA.

Contact

Tom Bettencourt, Branch Chief, HOME Investment Partnerships Program

Implementation Date

May 15, 2013

Reference Number:	2013-013
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME)
Federal Award Number and Year:	M12-SG060100; 2013
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Housing and Community Development (HCD)

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

During our fiscal year 2012-13 audit, we reported that HCD did not have a process in place to comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for the HOME program. Although HCD approved subawards greater than $25,000 it failed to timely report these subawards in the FFATA Subaward Reporting System within the required period. 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

HCD should implement policies and procedures to report subaward information under FFATA.

Department's View and Corrective Action Plan

HCD agrees with the finding. HCD will develop policies and procedures to report subaward information under the FFATA Act, by March 31, 2014.

Contact

Tom Bettencourt, Branch Chief, HOME Investment Partnerships Program

Implementation Date

March 31, 2014

U.S. DEPARTMENT OF JUSTICE

Reference Number:	2013-014
Federal Catalog Number:	16.738, 16.803
Federal Program Title:	JAG Program Cluster (ARRA)
Federal Award Number and Year:	2009-DJ-BX-0063; 2009 2011-DJ-BX-2181; 2011 2009-SU-B9-0009; 2009 2010-DJ-BX-0384; 2010
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Office of Emergency Services (CalOES)

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

CalOES does not have adequate controls to issue management decisions on findings reported in subrecipient OMB Circular A-133 reports within six months after receipt of the audit report. We tested six audits with findings related to the JAG Program Cluster and found three in which the management decision was not issued within six months of receipt of the subrecipient's OMB Circular A-133 report. Failure to issue management decisions in a timely manner may result in delays in recovery of questioned costs and corrective action.

Questioned Costs

No specific questioned costs were identified.

Recommendations

CalOES should strengthen its policies and procedures to ensure that management decisions are issued within six months after receipt of the subrecipient's OMB Circular A-133 report.

Department's View and Corrective Action Plan

CalOES concurs that it did not meet the deadline for issuance of Management Decision Letters (MDL) on three of the audits tested. These failures were due to the State's cumbersome process for receiving, reviewing and forwarding A-133 audit reports to State agencies. For example, in two instances, the audit reports were received by CalOES 31 and 52 days prior to the MDL due dates; in the final instance, a revised audit report and supplemental information from the auditor was not received until 18 days prior to the MDL due date. In all instances, CalOES did not have sufficient time to ensure appropriate corrective action was effected within six months of the initial receipt of the audits by the State.

CalOES will provide additional training to monitoring staff on use of the monitoring database "alert" system to track Management Decision Letter due dates in order to ensure timely corrective action for noncompliance issues. CalOES will also add an additional query of the Federal Audit Clearing House to its annual audit review process in an effort to independently identify and follow-up on subrecipient audit findings related to its major grant programs.

Contact

Catherine Lewis, Chief, Grants Monitoring Branch

Implementation Date

March 2014

Reference Number:	2013-015
Federal Catalog Number:	16.738
Federal Program Title:	JAG Program Cluster
Federal Award Number and Year:	2012-DJ-BX-1237
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Board of State and Community Corrections (BSCC)

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;

Condition

BSCC does not have adequate policies and procedures to monitor its JAG program subrecipients in accordance with federal requirements. BSCC took over administration of the JAG program from the California Office of Emergency Services beginning with 2013 JAG program grants. BSCC did not perform a risk assessment of subrecipients nor did it perform any during-the-award monitoring during fiscal year 2012-13 through site visits, limited scope audits, or other means. Failure to properly monitor subrecipients increases the risk that federal dollars will be paid for unallowable costs. In fiscal year 2012-13, the JAG program administered by BSCC expended $8.2 million, with $6.3 million passed through to subrecipients.

Questioned Costs

No specific questioned costs were identified.

Recommendations

BSCC should implement policies and procedures to ensure it properly monitors subrecipients. BSCC should perform a risk assessment of its subrecipients to determine for which grantees it should perform site visits, limited scope audits, or other monitoring procedures.

Department's View and Corrective Action Plan

BSCC agrees with this finding. BSCC will conduct site visits with all grantees receiving JAG grant funding above $500,000 and those grantees that have been problematic in the past.

Grantee Name	Reason for Audit	Date of the Audit
LaVerne PD	Grant Amount	April 2014
Monrovia PD	Grant Amount	June 2014
Los Angeles	Grant Amount	August 2014
Alpine	Problematic	October 2014
Shasta	Problematic	December 2014
Alameda	Grant Amount	January 2015

Limited scope audits using random invoice sampling will be conducted for all noncounty grantees.

Grantee Name	Reason for Audit	Date of the Audit
Cal-DOJ	Random Invoice	April/May 2014
Cal-DOJ	Random Invoice	June/July 2014
Homeboy Industries	Random Invoice	August/September 2014
Able-Disabled Advocacy, Inc	Random Invoice	October/November 2014
LA CAUSA, Inc	Random Invoice	December/January 2014/2015

Contact

William J. Crout, Deputy Director, Corrections Planning & Programs Division, Board of State and Community Corrections

Implementation Date

April 2014

U.S. DEPARTMENT OF LABOR

Reference Number:	2013-016
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster
Federal Award Number and Year:	AA-22924-12-55-A-6; 2013 AA-21384-11-55-A-6; 2013 AA-20183-10-55-A-6; 2013 AA-22924-12-55-A-6; 2012 AA-21384-11-55-A-6; 2012 AA-20183-10-55-A-6; 2012
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

During our audit for fiscal year 2011–12, we reported that EDD did not have adequate controls to issue management decisions on findings reported in subrecipient OMB Circular A-133 reports within six months after receipt of the audit report. In fiscal year 2012–13, we tested four of 11 audit reports with WIA Cluster findings and found one in which the management decision was not issued within six months of receipt of the subrecipient's OMB Circular A-133 report. Failure to issue management decisions in a timely manner may result in delays in recovery of questioned costs and proper corrective action.

Questioned Costs

No specific questioned costs were identified.

Recommendations

EDD should strengthen its policies and procedures to ensure that management decisions are issued within six months after receipt of the subrecipient's OMB Circular A-133 report.

Department's View and Corrective Action Plan

The EDD concurs with the recommendation. The EDD implemented its corrective action plan stated in the auditor's report issued in March 2013. The incident involving the one management decision letter noted in the current year audit that was issued subsequent to the six-month requirement occurred prior to EDD implementing corrective actions in March 2013.

The EDD continues using online automated tools to track the status of management decision letters and send automated alerts to keep the decision process on schedule.

Contact

Jessie Mar, Staff Services Manager III – Compliance Review Office, Policy, Accountability and Compliance Branch

Implementation Date

March 2013

Reference Number:	2013-017
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster
Federal Award Number and Year:	AA-22924-12-55-A-6; 2013 AA-21384-11-55-A-6; 2013 AA-20183-10-55-A-6; 2013 AA-22924-12-55-A-6; 2012 AA-21384-11-55-A-6; 2012 AA-20183-10-55-A-6; 2012
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

During our audit for fiscal year 2011–12, we reported that EDD did not properly obtain DUNS numbers from its subrecipients prior to awarding WIA Cluster funds. In response to our finding, EDD implemented policies to obtain DUNS numbers prior to issuing new subgrants. However, in fiscal year 2012–13, our testwork found that EDD did not obtain DUNS numbers prior to issuing 32 of 40 subgrants tested. Failure to obtain the DUNS numbers prior to awarding funds increases the risk that EDD may not properly report subaward information to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

EDD should implement its revised procedures to obtain DUNS numbers from subrecipients prior to approving subawards of federal funds.

Department's View and Corrective Action Plan

The EDD concurs with the recommendation. The EDD took action to correct the deficiency on February 4, 2013, by revising the Subgrantee Tax Identification form which is sent out for completion with all bilateral (new) subgrant packages to include a request for the DUNS number.

The EDD determined that the 32 subgrant awards found to be non-compliant with the DUNS number requirement were funded prior to the February 4, 2013 corrective action implementation date. The EDD also determined that those subgrant awards found compliant were funded after the corrective actions were implemented and the DUNS numbers were obtained from the subrecipients prior to awarding WIA funds.

The EDD maintains a complete list of DUNS numbers in the Financial Management Unit share drive and has placed a hard copy of the DUNS numbers list in each funding binder since February 4, 2013. The EDD has effectively addressed this finding.

Contact

Melissa Bowen, Deputy Division Chief – Budget, Policy, Capacity Building and Administration Section, Workforce Services Branch

Implementation Date

February 4, 2013

Reference Number:	2013-018
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster
Federal Award Number and Year:	AA-22924-12-55-A-6; 2013 AA-21384-11-55-A-6; 2013 AA-20183-10-55-A-6; 2013 AA-22924-12-55-A-6; 2012 AA-21384-11-55-A-6; 2012 AA-20183-10-55-A-6; 2012

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

During our audit for fiscal year 2011–12, we reported that 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. In fiscal year 2012-13, EDD made a good faith effort to report information for one subrecipient in the Federal Funding Accountability and Transparency Act Subaward Reporting System (FSRS). However, the subrecipient was not yet listed in FSRS. EDD was not aware that it could report information for other subrecipients who were listed within FSRS, and as a result, did not report required information for 39 of 40 subgrants tested. Failure to implement adequate processes and controls over FFATA reporting increases when the subaward information is not reported in accordance with federal requirements.

Questioned Costs

No specific questioned costs were identified.

Recommendations

EDD should strengthen its policies and procedures over FFATA reporting to ensure subaward information is reported in accordance with federal requirements.

Department's View and Corrective Action Plan

The EDD concurs with the recommendation. The EDD had taken immediate action to correct the original deficiency from the audit for State Fiscal Year 2011-12. The 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 FFATA reporting requirements. The EDD received confirmation of successful submission of the Program Year (PY) 2011-12 FFATA on September 26, 2013, and of the PY 2012-13 FFATA report on September 30, 2013. The EDD is currently inputting FFATA information for PY 2013-14. The EDD has effectively addressed this finding.

Contact

Melissa Bowen, Deputy Division Chief – Budget, Policy, Capacity Building and Administration Section, Workforce Services Branch

Implementation Date

September 30, 2013

Reference Number:	2013-019
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance (UI)
Federal Award Number and Year:	UI-23881-13-55-A-6; 2013 UI-22264-12-55-A-6; 2012
Category of Finding:	Reporting; Special Tests and Provisions
Type of Finding:	Significant Deficiency
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 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 refers to the protection of information, information systems, equipment, software 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, optical, oral, print, or other media) is critical to ensure business continuity, and protect information assets against unauthorized access, use, disclosure, disruption, modification, or destruction. Information security is also the means by which privacy of personal information held by state entities is protected.

State Administrative Manual, Section 5365 – Each state entity shall establish and implement physical security and environmental protection controls to safeguard information assets against unauthorized access, use, disclosure, disruption, modification, or destruction.

Condition

During our audit for fiscal year 2011–12, we reported that information technology controls over logical access and change management for the Accounting and Compliance Enterprise System (ACES) were not properly designed or operating effectively. EDD uses ACES to calculate tax liabilities and process tax payment information and experience ratings for employers. In fiscal year 2012–13, we also found certain information technology controls over logical access and change management within ACES were not properly designed or operating effectively. We found the following:

- 23 of 32 terminated employees' system access was not deactivated timely from ACES or the system's Active Directory.

- 14 of 65 system changes tested were not properly approved prior to implementation.

- Six employees had access to approve and promote code changes to the staging environment, which does not promote proper segregation of duties.

Failure to maintain adequate information technology controls over logical access and change management could result in inaccurate or incomplete calculations of tax liabilities and processing of tax payment information and experience ratings.

Questioned Costs

No specific questioned costs were identified.

Recommendations

EDD should strengthen ACES information technology controls over logical access and change management. Specifically, EDD should:

1. Remove access upon termination and maintain evidence to reflect timely deactivation.

2. Ensure program changes are approved by authorized individuals prior to implementation.

3. Enforce segregation of duties so that employees cannot approve and promote changes to ACES staging environment.

Department's View and Corrective Action Plan

The EDD concurs with the recommendation. The EDD will address timely deactivation of terminated employees. The EDD has modified the instructions for the ACES access activation and deactivation request to address the identified deficiencies and is working to modify its Appointment/Separation Checklist (DE 7411) to include a step for notifying the proper unit of user terminations. The EDD ACES reminds managers and external agency single point of contacts quarterly to timely submit a security case or e-mail request whenever a user transfers or separates. The EDD ACES modified the quarterly process to automatically deactivate users with 90 days or more of inactivity to a nightly process in March 2013. In September 2013, ACES began receiving the Monthly Separation Reports from EDD's Human Resource Services Division in order to deactivate separated employees in a more timely manner.

In response to the 14 out of 65 changes not being recorded in the Change Control Board (CCB) meeting minutes, it appears that seven are identified as prior to EDD implementing a process change on August 23, 2012, of recording the reviewed and approved changes in the CCB meeting minutes. Of the remaining seven Solution Request Managers, three were service pack component migrations, and four changes resulted from developers and business analysts errors in labeling the changes such that those changes did not go before the CCB for approval. The EDD will continue to work with its developers and business analysts to ensure changes are properly labeled and all changes requiring CCB approval are properly reviewed.

The EDD will work to improve change control for ACES. All code changes made through the Solution Request Manager must go through multiple levels of approval, including the CCB, before being migrated into production. As an added security measure, the software used for the ACES code migration prevents any code changes once it enters the staging environment. Additional steps have been taken to improve documentation of changes approved by the CCB. Notes are added to each item (migration or task) that has been approved by CCB. The CCB meeting minutes contain a record of all migrations or tasks discussed and approved in the CCB, including those that are being pulled back from migration.

Segregation of duties is handled systematically as shown above but also procedurally. The EDD has policies in place to address the ability of a lead programmer to approve his/her own code changes. All lead developers have the ability to approve standard changes for their team members. However, the team leads cannot approve their own changes; instead they have to seek approval for their programming changes via their counterpart lead or by the application architects. The application architects and the infrastructure architect will seek approval from each other ensuring that they will not approve their own changes. In addition, the Business Analyst needs to review, test, and approve the migration.

Finally, EDD will reevaluate its business practices relating to how employees are deactivated from Active Directory. This evaluation will focus on identifying potential changes in EDD policies, procedures, and systems that will result in terminated employees being deactivated from the system within an acceptable time period.

Contact

Carol Hallett, Alan Cooper and Rafael Rosas, EDD ACES Tax Branch
Andrew Hall, Jan Yoshioka and Navin Arora, EDD ACES IT Branch
James Matsudo and Joe Wong, EDD Active Directory IT Branch

Implementation Date

Administration Branch is making changes to DE 7411 to include ACES. The revision is tentatively to be completed and published in the spring of 2014.

U.S. DEPARTMENT OF TRANSPORTATION

Reference Number:	2013-020
Federal Catalog Number:	20.205 (ARRA)
Federal Program Title:	Highway Planning and Construction Cluster (Highway Planning)
Federal Award Number and Year:	N4510.765; 2013 N4510.758; 2012 N4520.208; 2011
Category of Finding:	Special Tests and Provisions
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

Criteria

23 CFR Section 637.209 Quality Assurance: The preparation of a materials certification, conforming in substance to Appendix A of this subpart, shall be submitted to the Federal Highway Administration (FHWA) Division Administrator for each construction project which is subject to FHWA construction oversight activities.

Condition

Caltrans did not have adequate controls in place to ensure required materials certifications were prepared. Caltrans was unable to locate materials certifications for ten of 40 projects selected for quality assurance requirements testing. The materials certifications provide evidence that proper tests were performed in accordance with the approved Caltrans' quality assurance program. Failure to maintain support for materials certification testing increases the risk that materials do not conform to approved plans and specifications.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should implement a process to maintain materials certifications to support tests performed in accordance with its quality assurance program.

Department's View and Corrective Action Plan

Caltrans recognizes the importance of preparation and maintenance of required project documentation. The required project records to be retained are documented in the Caltrans Construction Manual. Caltrans has procedures in place that detail the records to be assembled with a checklist requiring sign-off as to the completeness of the project history file. This year's audit has found instances where staff has not complied with Caltrans record retention procedures and Caltrans appreciates the feedback that helps to make continuous improvements in our procedures.

Caltrans developed and issued a new Construction Policy Directive (CPD) on October 24, 2013, which was sent to all districts. The CPD focuses on the importance of proper document retention in accordance with Federal regulations and requirements, as well as on providing training as needed to ensure that project documentation is complete. In addition, the Caltrans Construction Manual was revised to include a detailed list of documents that are to be maintained indefinitely in the project history file. Caltrans will be updating the Construction Manual procedures with respect to a single procedure to be implemented on a uniform basis throughout the State.

Contact

John Bittermann, Senior Engineer, Division of Construction

Implementation Date

June 30, 2015

Reference Number:	2013-021
Federal Catalog Number:	20.205 (ARRA)
Federal Program Title:	Highway Planning and Construction Cluster (Highway Planning)
Federal Award Number and Year:	N4510.765; 2013 N4510.758; 2012 N4520.208; 2011
Category of Finding:	Activities Allowed/Allowable Costs, Cash Management, Matching, and Reporting
Type of Finding:	Significant Deficiency
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 refers to the protection of information, information systems, equipment, software 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, optical, oral, print, or other media) is critical to ensure business continuity, and protect information assets against unauthorized access, use, disclosure, disruption, modification, or destruction. Information security is also the means by which privacy of personal information held by state entities is protected.

State Administrative Manual, Section 5365 – Each state entity shall establish and implement physical security and environmental protection controls to safeguard information assets against unauthorized access, use, disclosure, disruption, modification, or destruction.

Condition

During our audit for fiscal year 2011-12, we reported the information technology controls over logical access to the Caltrans Advantage Financial ERP system (Advantage) were not properly designed. In fiscal year 2012-13, Caltrans took corrective action to correct the deficiencies identified in the 2011-12 audit. However, we found certain other information technology controls over logical access and change management within Advantage were not properly designed and operating effectively. Caltrans uses

Advantage as its accounting system and to maintain federal compliance since the system is configured to calculate and submit requests to the Federal Highway Administration (FHWA) for the Highway Planning grant for reimbursement, calculate the State's share of expenditures (matching), and report expenditures to FHWA for the Highway Planning grant. In fiscal year 2012-13, we noted the following:

- Although Caltrans has a policy that requires a quarterly review of Advantage user access and a process to gather responses from managers, the manager responses are not consistently obtained.

- Advantage users that are considered administrative in nature, including users with the ability to approve the creation or modification of contracts, are excluded from the quarterly review of user access. The Security Admin team performs this review informally; however, there is no evidence of the review.

- The DOT AD group used to manage administrative access to Advantage servers and the workstations used to compile codes for production builds include developers and terminated employees.

- We found three instances in which members of the cashiering group had access to the ALL_TABLES admin role, which allows them to maintain all tables in the Advantage application. We also found one instance where an information technology developer changed job positions to an accounts payable clerk but the user's administrative access was not revoked. These instances increase segregation of duties risk because users have the ability to create contracts, receive goods /services, invoice, and issue payments.

- Some system change approvals may be provided verbally and documented after the change implementation date. In addition, change control documentation templates were not consistently utilized and e-mail change approvals were lost due to a mail server outage.

- The Unix administration team does not have unique user IDs to implement changes.

Failure to implement adequate information technology controls over logical access and change management could result in unallowable costs or inaccurate or incomplete draws, matching and reporting through Advantage.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen Advantage information technology controls over logical access and change management. Specifically, Caltrans should:

1. Ensure manager responses are obtained from Advantage user access reviews.

2. Ensure all user access is reviewed by the appropriate team and evidence of the review is maintained.

3. Assign access to servers and workstations to appropriate and authorized individuals.

4. Implement proper segregation of duties for user access to the ALL_TABLES admin role and a process to ensure that user access roles are reviewed and revoked as necessary for any changes in job roles and descriptions.

5. Maintain approval evidence of system changes in accordance with the Caltrans change management policy.

6. Implement unique user IDs for the Unix administration team.

Department's View and Corrective Action Plan

Caltrans concurs with the recommendations:

1. Caltrans conducts quarterly Gatekeeper reviews. Previously, access was not removed if no response to the Gatekeeper request was received. Beginning with the January 2014 quarterly Gatekeeper review, Caltrans has changed the process to include follow-up to those Gatekeepers who did not respond. If the Gatekeeper does not respond to the follow-up request, users will be notified that access will be removed if no response to the request is received by a certain date. Documentation to support the quarterly reviews will be maintained.

2. Beginning in February 2014 and every month thereafter, Caltrans Chief of Fiscal Systems Management Branch, Division of Accounting, will review the Advantage users that are considered administrative in nature for appropriate user access. Documentation to support the review will be maintained.

3. Caltrans has had a process in place for granting and removing user access to servers and workstations. Caltrans conducts quarterly Gatekeeper reviews. Previously, access was not removed if no response to the Gatekeeper request was received. Caltrans has changed the process and will remove access if no response to the Gatekeeper request is received.

4. Beginning in February 2014 and every month thereafter, Caltrans Chief of Fiscal Systems Management Branch, Division of Accounting, will review the Advantage Admin Roles to ensure that users are assigned proper Admin Roles based on their job requirements and that proper segregation of duties exists. Documentation to support the monthly reviews will be maintained. The All_Update Role has been removed from the three members of the Cashiering group and they have been assigned the appropriate roles. In addition, the Administrative Role has been removed from the Accounts Payable staff.

5. Caltrans has a change-management policy in place, which includes guidelines. The lack of retained documentation was the result of staff oversight. This policy is distributed to IT staff annually and was last distributed to IT staff on January 13, 2014. Caltrans will conduct quarterly reviews beginning in April 2014 to ensure compliance with the change-management policy and will retain documentation to support system changes.

6. Currently, the Unix administration team does have unique user IDs. Caltrans has a policy in place that requires the root password and on-call staff password be changed on a system when an administrator other than the primary system administrator obtains the root or on-call password. When an administrator receives the system-generated email that the on-call administrator has viewed the password for a system, they will change the root and on-call passwords within one business day, and update the database with the change. Administrators were reminded of the procedures during a staff meeting on February 13, 2014. The current system only allows authorized Operating Systems Support Branch administrators to access the root and on-call passwords for a system.

Contact

1. Terry Zanchi, Office of Receivables and System Administration, Division of Accounting
2. Terry Zanchi, Office of Receivables and System Administration, Division of Accounting
3. David Salyer, Packaged Products Solutions Branch, Division of Information Technology
4. Terry Zanchi, Office of Receivables and System Administration, Division of Accounting
5. David Salyer, Packaged Products Solutions Branch, Division of Information Technology
6. Patrick Doyle, Operating Systems Support Branch, Division of Information TechnologyImplementation Date

See above.

Reference Number:	2013-022
Federal Catalog Number:	20.319 (ARRA)
Federal Program Title:	High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants (High Speed Rail)
Federal Award Number and Year:	FR-HSR-0116-12-01-00; 2012 FR-HSR-0068-11-01-01; 2012 FR-HSR-0036-11-01-01; 2011 FR-HSR-0022-11-01-00; 2011 FR-HSR-0018-11-01-01; 2010
Category of Finding:	Davis Bacon Act
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

Criteria

Title 29: Labor, PART 5—LABOR STANDARDS PROVISIONS APPLICABLE TO CONTRACTS COVERING FEDERALLY FINANCED AND ASSISTED CONSTRUCTION (ALSO LABOR STANDARDS PROVISIONS APPLICABLE TO NONCONSTRUCTION CONTRACTS SUBJECT TO THE CONTRACT WORK HOURS AND SAFETY STANDARDS ACT), Subpart A—Davis-Bacon and Related Acts Provisions and Procedures, §5.5 Contract provisions and related matters.

(a) The Agency head shall cause or require the contracting officer to insert in full in any contract in excess of $2,000 which is entered into for the actual construction, alteration and/or repair, including painting and decorating, of a public building or public work, or building or work financed in whole or in part from Federal funds or in accordance with guarantees of a Federal agency or financed from funds obtained by pledge of any contract of a Federal agency to make a loan, grant or annual contribution (except where a different meaning is expressly indicated), and which is subject to the labor standards provisions of any of the acts listed in §5.1, the following clauses (or any modifications thereof to meet the particular needs of the agency, *Provided,* That such modifications are first approved by the Department of Labor):

(1) Minimum wages. (i) All laborers and mechanics employed or working upon the site of the work (or under the United States Housing Act of 1937 or under the Housing Act of 1949 in the construction or development of the project), will be paid unconditionally and not less often than once a week, and without subsequent deduction or rebate on any account (except such payroll deductions as are permitted by regulations issued by the Secretary of Labor under the Copeland Act (29 CFR part 3)), the full amount of wages and bona fide fringe benefits (or cash equivalents thereof) due at time of payment computed at rates not less than those contained in the wage determination of the Secretary of Labor which is attached hereto and made a part hereof, regardless of any contractual relationship which may be alleged to exist between the contractor and such laborers and mechanics.

(ii)(A) The contractor shall submit weekly for each week in which any contract work is performed a copy of all payrolls to the (write in name of appropriate federal agency) if the agency is a party to the contract, but if the agency is not such a party, the contractor will submit the payrolls to the applicant, sponsor, or owner, as the case may be, for transmission to the (write in name of agency). The payrolls submitted shall set out accurately and completely all of the information required to be

> maintained under 29 CFR 5.5(a)(3)(i), except that full social security numbers and home addresses shall not be included on weekly transmittals. Instead the payrolls shall only need to include an individually identifying number for each employee (e.g., the last four digits of the employee's social security number).

Condition

Caltrans does not have procedures in place to comply with federal Davis Bacon Act requirements for the High Speed Rail program. Caltrans did not obtain certified weekly payrolls from contractors. In addition, one of two contracts tested did not contain the clauses for prevailing wage rate requirements. Failure to include the prevailing wage rate clauses and determine that the contractor or subcontractor submitted the required weekly certified payrolls increases the risk of noncompliance with Davis Bacon Act requirements.

Questioned Costs

Not determined.

Recommendations

Caltrans should strengthen its process over Davis Bacon Act requirements to ensure prevailing wage rate requirements are included in the contract. Caltrans should also implement procedures to obtain weekly the required certified payrolls.

Department's View and Corrective Action Plan

Caltrans concurs with the recommendations.

The Division of Rail will add the required language to the standard provisions for future subrecipient contract agreements under which Davis Bacon requirements are applicable. Caltrans has a contract which is governed by labor relations as defined by the Federal Railway Labor Act, whereby workers covered by this act are exempt from Davis Bacon requirements. For projects under which Davis Bacon requirements are applicable, documentation of certified payrolls will be required to be submitted with invoice reimbursement requests. In addition, grant managers will review the requests, which will be followed by invoice payment approval by the supervisor.

Contact

Crystal Ortiz, Division of Rail

Implementation Date

September 30, 2014

Reference Number:	2013-023
Federal Catalog Number:	20.319 (ARRA)
Federal Program Title:	High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants (High Speed Rail)
Federal Award Number and Year:	FR-HSR-0116-12-01-00; 2012 FR-HSR-0068-11-01-01; 2012 FR-HSR-0036-11-01-01; 2011 FR-HSR-0022-11-01-00; 2011 FR-HSR-0018-11-01-01; 2010

Category of Finding: Suspension & Debarment, Special Tests and Provisions
Type of Finding: Significant Deficiency and Instance of Noncompliance
State Administering Department: California Department of Transportation (Caltrans)

Criteria

TITLE 2: GRANTS AND AGREEMENTS, PART 180—COVERED TRANSACTIONS, Subpart C—Responsibilities of Participants Regarding Transactions Doing Business with Other Persons.

When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified.
You do this by:

(a)Checking the EPLS; or
(b)Collecting a certification from that person; or
(c)Adding a clause or condition to the covered transaction with that person.

2 CFR SECTION 176.210 AWARD TERM—RECOVERY ACT TRANSACTIONS LISTED IN SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND RECIPIENT RESPONSIBILITIES FOR INFORMING SUBRECIPIENTS.

(b) For recipients covered by the Single Audit Act Amendments of 1996 and OMB Circular A–133, *Audits of States, Local Governments, and Non-Profit Organizations,* recipients agree to separately identify the expenditures for Federal awards under the Recovery Act on the Schedule of Expenditures of Federal Awards (SEFA) and the Data Collection Form (SF–SAC) required by OMB Circular A–133. OMB Circular A–133 is available at *http://www.whitehouse.gov/omb/circulars/a133/ a133.html*. This shall be accomplished by identifying expenditures for Federal awards made under the Recovery Act separately on the SEFA, and as separate rows under Item 9 of Part III on the SF–SAC by CFDA number, and inclusion of the prefix "ARRA-" in identifying the name of the Federal program on the SEFA and as the first characters in Item 9d of Part III on the SF–SAC.

Condition

Caltrans does not have adequate controls in place to ensure all subcontracts of the High Speed Rail program include required clauses or conditions. Caltrans did not include covered transactions clauses or conditions for one of two subcontracts selected for testing nor did it check the EPLS or obtain a certification. Failure to include proper clauses and conditions in contracts could result in Caltrans reimbursing subrecipients who have been suspended or debarred. In addition, for the two subawards tested, the contract did not communicate requirements for SEFA and SF-SAC presentation as required for ARRA-funded awards. Failure to communicate SEFA and SF-SAC presentation increases the risk that ARRA requirements may not be followed by subrecipients.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen its policies and procedures to ensure contracts include required clauses and conditions.

Department's View and Corrective Action Plan

The Division of Rail, with assistance from Caltrans Legal and Caltrans Division of Procurement and Contracts DPAC, will add the required language to the standard provisions for future sub-recipient contract agreements. Additionally, staff will be trained to check the EPLS and to maintain supporting documents in the project history files.

Contact

Crystal Ortiz, Division of Rail

Implementation Date

June 30, 2014

Reference Number:	2013-024
Federal Catalog Number:	20.319 (ARRA)
Federal Program Title:	High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants (High Speed Rail)
Federal Award Number and Year:	FR-HSR-0032-11-01-01; 2011 FR-HSR-0021-11-01-00; 2011 FR-HSR-0022-11-01-00; 2011
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Material Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – A*UDITS 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.

Federal Financial Report (FFR) (SF-425/SF-425A (OMB No. 0348-0061)). Recipients use the FFR as a standardized format to report expenditures under Federal awards, as well as, when applicable, cash status (Lines 10.a, 10.b, and 10c). References to this report include its applicability as both an expenditure and a cash status report unless otherwise indicated.

Condition

Caltrans does not have adequate controls in place to ensure accuracy of Federal Financial Reports (SF-425) submitted for the High Speed Rail program, including reconciliation to supporting documents. Caltrans did not accurately report the federal share of expenditures for three of nine SF-425 reports tested, resulting in a net understatement of $2,474,375 of federal expenditures. Failure to reconcile reports to supporting documents increases the risk of errors in information reported to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen its process over reconciliation and review of SF-425 reports to ensure accuracy of the reports prior to submission.

Department's View and Corrective Action Plan

The Division of Rail has developed a tracking tool for grant managers (Excel spreadsheet) that calculates the amounts to be reported on the SF-425, with validation and approval being performed by the grant manager's supervisor prior to submitting the reports to FRA, and has developed training to be provided to all employees on the use of this tool for SF-425 reporting.

Contact

Crystal Ortiz, Division of Rail

Implementation Date

June 30, 2014

Reference Number:	2013-025
Federal Catalog Number:	20.319 (ARRA)
Federal Program Title:	High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants (High Speed Rail)
Federal Award Number and Year:	FR-HSR-0058-11-01-00; 2011 FR-HSR-0021-11-01-00; 2011 FR-HSR-0018-11-01-01; 2010
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Material Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

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 subrecipient 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 subrecipient 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 subrecipient.

Condition

Caltrans does not have adequate controls in place to ensure High Speed Rail program Section 1512 reports are accurate, including reconciliation to supporting documents. Caltrans did not accurately report the federal share of expenditures for three of the eight Section 1512 reports tested, resulting in a net understatement of $9,524,055 of federal expenditures. Failure to reconcile reports to supporting documents increases the risk of errors in information reported to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen its process over reconciliation and review of Section 1512 reports to ensure accuracy of the reports prior to submission.

Department's View and Corrective Action Plan

The 1512 reports are a quarterly requirement and the understatements identified have been corrected as of the January 30, 2014 reporting deadline. Data entry required for the 1512 reports was first uploaded through the Caltrans CRIS - California Recovery Input System. Process improvements were implemented by requiring staff who enter the data to log into the website *www.FederalReporting.gov* after the batch upload and verify that all data is entered correctly. Congress repealed the recipient reporting for Recovery Act awards as of February 1, 2014. Therefore, the January 2014 reporting cycle was the last time grant recipients were required to report on an ARRA award grant, ending the requirement to submit 1512 reports.

Contact

Sharon Beasley, Division of Rail

Implementation Date

January 30, 2014

Reference Number:	2013-026
Federal Catalog Number:	20.509

Federal Program Title:	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program)
Federal Award Number and Year:	CA-18-X052-00; 2012 CA-85-X004-00; 2011 CA-18-X047-00; 2011 CA-85-X003-00; 2010 CA-18-X043-00; 2010 CA-18-X035-00; 2010 CA-86-X001-00; 2009 CA-18-X028-00; 2008 CA-85-X001-00; 2007 CA-18-X025-00; 2007
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
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 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.

Condition

Caltrans does not have a process in place to ensure subrecipients who expend more than $500,000 in federal awards submit single audit reports as required by OMB Circular A-133. In fiscal year 2012-13, Caltrans passed Formula Grants funding to 92 subrecipients, including 26 cities, 19 counties, one town, and 46 special districts.

The State Controller's Office (SCO) obtains and reviews OMB Circular A-133 reports for all cities, counties, and towns that report more than $500,000 in federal expenditures. The SCO then sends those reports with findings to Caltrans for follow-up. Caltrans only monitors the submission of the OMB Circular A-133 reports obtained from the SCO as well as special districts who expend more than $500,000 in federal awards from Caltrans. We identified 31 2012 special district OMB Circular A-133 reports that were not reviewed by Caltrans because they expended less than $500,000 in federal awards received from Caltrans. In fiscal year 2012-13, Caltrans passed $2.7 million through to subrecipients that expended less than $500,000 in Formula Grants funds. Since Caltrans did not review these reports, it cannot determine if the Formula Grants program was audited and whether or not findings were issued that required a management decision from Caltrans. Failure to obtain and review single audit reports of subrecipients increases the risk that subrecipients may have spent monies for unallowable purposes or failed to comply with other federal regulations.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should obtain and review single audit reports of all subrecipients who expend more than $500,000 in federal awards and issue management decisions, as necessary.

Department's View and Corrective Action Plan

Caltrans will implement a process to ensure it obtains and reviews single audit reports, as necessary, for all special districts for which it passes through federal funds. As stated in the condition above, the State Controller's Office currently obtains single audit reports for all cities, counties, and towns, and forwards these reports to Caltrans.

Contact

MarSue Morrill, Audits and Investigations

Implementation Date

Caltrans will implement immediately for the current Fiscal Year 2013 cycle.

Reference Number:	2013-027
Federal Catalog Number:	20.509
Federal Program Title:	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program)
Federal Award Number and Year:	CA-18-X052-00; 2012 CA-85-X004-00; 2011 CA-18-X047-00; 2011 CA-85-X003-00; 2010 CA-18-X043-00; 2010 CA-18-X035-00; 2010 CA-86-X001-00; 2009 CA-18-X028-00; 2008 CA-85-X001-00; 2007 CA-18-X025-00; 2007
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
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

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.

Federal Financial Report (FFR) (SF-425/SF-425A (OMB No. 0348-0061)). Recipients use the FFR as a standardized format to report expenditures under Federal awards, as well as, when applicable, cash status (Lines 10.a, 10.b, and 10c). References to this report include its applicability as both an expenditure and a cash status report unless otherwise indicated.

Condition

Caltrans does not have proper controls in place to evidence its review of the SF-425, Federal Financial Report, prior to submission. In addition, Caltrans could not provide supporting amounts reported for line items G and J for four SF-425 reports selected for testing. Failure to retain supporting documentation for amounts reported and maintain adequate review controls increases the risk that Caltrans may report inaccurate information to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen controls over its reporting process to include evidence of review by someone other than the preparer prior to submission. Caltrans should also retain supporting documentation for amounts reported in the SF-425 reports.

Department's View and Corrective Action Plan

Caltrans agrees to strengthen controls to include evidence of SF-425 reviews by someone other than the preparer prior to submission. Caltrans will review procedures with involved staff and ensure that supporting documentation is retained to evidence this review.

Caltrans also agrees that it could not provide supporting documentation for elements of SF-425 reports; such documentation is required by current Caltrans procedures. Caltrans will review procedures with involved staff and ensure that supporting documentation is retained for amounts reported in the SF-425 reports.

Contact

Grace Kong, Chief, Office of Project Accounting

Implementation Date

February 28, 2014

Reference Number:	2013-028
Federal Catalog Number:	20.509
Federal Program Title:	Formula Grants for Other than Urbanized Areas (Nonurbanized Area Formula Program)
Federal Award Number and Year:	CA-18-X052-00; 2012 CA-85-X004-00; 2011 CA-18-X047-00; 2011 CA-85-X003-00; 2010 CA-18-X043-00; 2010 CA-18-X035-00; 2010 CA-86-X001-00; 2009 CA-18-X028-00; 2008 CA-85-X001-00; 2007 CA-18-X025-00; 2007

Category of Finding:	Cash Management
Type of Finding:	Significant Deficiency
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

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

Caltrans does not have proper controls in place to evidence its review of cash draws prior to submission to the Federal government. We tested four of 15 draws and found three in which there was no evidence of review of the draw prior to submission. Failure to maintain adequate controls increases the risk that Caltrans may draw down inaccurate amounts of federal funds.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Caltrans should strengthen controls over the cash drawdown process to include evidence of review by someone other than the preparer prior to submission.

Department's View and Corrective Action Plan

Caltrans procedures require that draws are prepared and submitted by staff in the Division of Accounting and that draws are reviewed and approved by separate staff in the Division of Mass Transportation.

Caltrans agrees that documentation of review and approval of some draws had not been retained in accordance with procedures. This lack of retained documentation was the result of employee oversight. Caltrans has reviewed procedures with involved staff and will ensure that the procedures are followed to retain this supporting documentation in the future.

Contact

Grace Kong, Chief, Office of Program Accounting

Implementation Date

December 1, 2013

U.S. DEPARTMENT OF EDUCATION

Reference Number:	2013-029
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 Year:	S010A120005A; 2012 S010A110005A; 2011 S010A100005A; 2010

Federal Catalog Number:	10.565
Federal Program Title:	Food Distribution Cluster
Federal Award Number and Year:	7CA810CA1; 2013 7CA400CA2; 2013 7CA400CA2; 2012

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education – State Grant Program
Federal Award Number and Year:	S011A120005; 2012 S011A110005; 2011 S011A100005; 2010

Federal Catalog Number:	84.027, 84.173 (ARRA)
Federal Program Title:	Special Education Cluster (IDEA)
Federal Award Number and Year:	H027A120116; 2012 H173A120120; 2012 H027A110116; 2011 H173A110120; 2011 H173A100120; 2010 H027A100116; 2010

Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A100013-12; 2012 U282A100013-11; 2011 U282A100013A; 2010

Federal Catalog Number:	84.377
Federal Program Title:	School Improvement Grants Cluster
Federal Award Number and Year:	S377A110005; 2011 S377A100005; 2010

Federal Catalog Number:	84.410
Federal Program Title:	Education Jobs
Federal Award Number and Year:	S410A100005-10A; 2010 S410A100005; 2010

Federal Catalog Number:	10.553, 10.555, 10.556, 10.559
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Year:	7CA300CA3; 2012 7CA300CA3; 2011

Federal Catalog Number:	93.575, 93.596
Federal Program Title:	Child Care and Development Fund Cluster
Federal Award Number and Year:	G1201CACCDF; 2012 G1201CACCD7; 2012 G1101CACCDF; 2011 G1101CACCD7; 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

During our audit for fiscal year 2011-12, we reported that Education did not have an adequate process or controls in place to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) was properly reported for each of its federally funded programs. Similar to fiscal year 2011-12, Education only reported subaward information for the Career and Technical Education – Basic Grants to States program in fiscal year 2012-13 but did not report information for any other programs. 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

Education should implement policies and procedures to submit information for all federal programs as required by FFATA.

Department's View and Corrective Action Plan

Education accepts the recommendation. During fiscal year 2012-13, Education implemented a reporting schedule and designed processes that would ensure compliance with the requirements of the Federal Funding Accountability Transparency Act Subaward Reporting System (FSRS).

As a pilot, Special Education data was successfully uploaded to the FSRS; Education anticipates that information for other federal programs will be uploaded to the FSRS accordingly.

Contact

Mark Baude, Accounting Administrator III, Fiscal and Administrative Services Division

Implementation Date

January 2014

Reference Number:	2013-030
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education – State Grant Program
Federal Award Number and Year:	S010A120005; 2012 S010A110005; 2011 S010A100005; 2010
Category of Finding:	Reporting; Special Tests and Provisions
Type of Finding:	Significant Deficiency and Instance of Noncompliance
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) (OMB No. 1810-0614)

A state educational 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; RE-INTERVIEWING; 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

During our audit for fiscal year 2011-12, we found that Education does not review or evaluate the counts of migrant students. 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. Furthermore, Education does not review or 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 the information is accurate and complete.

Department's View and Corrective Action Plan

Education accepts the recommendation. In 2012–13, Education matched Migrant Student Information Network (MSIN) data with data from the California Longitudinal Pupil Achievement Data System (CALPADS) and determined that 93 percent of students in kindergarten through twelfth grade had a valid Statewide Student Identifier (SSID). Education will continue this matching process in 2013–14 and forward. In addition, Education will implement a new data reconciliation policy whereby MEP staff will work with local district CALPADS administrators to review and reconcile student files.

To further improve the quality of data accuracy, Education's nonprofit data management organization provides Education biweekly updates on pending and incorrect information found in MSIN. Education reviews these reports and contacts regions to provide technical assistance to remedy any identified data quality issues.

In September 2013, Education developed the enclosed 2013–14 Migrant Education Office Plan for Obtaining and Verifying SSIDs. In November 2013, Education commenced implementation of the plan; full implementation is scheduled for March 1, 2014.

Contact

Fernando Rodriguez-Valls, Administrator, Migrant Education Office
Karen Cadiero-Kaplan, Director English Learner Support Division

Implementation Date

November 2013 - March 2014

Reference Number:	2013-031
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education – Basic Grants to States (Perkins IV)
Federal Award Number and Year:	V048A120005; 2012 V048A110005; 2011 V048A100005; 2010

Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	California Community Colleges Chancellor's Office (Chancellor's Office)

Criteria

TITLE 31 – MONEY AND FINANACE, 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

During our audit for fiscal year 2011-12, we reported that the California Community Colleges Chancellor's Office (Chancellor's Office) lacked adequate controls to monitor the use of federal awards through site visits, limited scope audits, or other means and did not review community college district OMB Circular A-133 audits for findings related to the Career and Technical Education (CTE) program. The Chancellor's Office relied on its review of quarterly expenditure reports submitted by community college districts to determine if expenditures were allowable; however, those reports contained summarized data and did not include other support such as invoices or receipts. In response to the finding, in fiscal year 2012-13 the Chancellor's Office developed a risk-based monitoring plan, including a selection process for site visits and desk reviews. However, no site visits, desk reviews or other monitoring procedures were performed in fiscal year 2012-13. In addition, we tested subrecipient OMB Circular A-133 reports and found that six of the 72 subrecipients had CTE program findings. The Chancellor's Office did not issue management decisions within the required six months for these findings. Failure to properly monitor subrecipients increases the risk that Federal funds may be spent for unallowable purposes.

Questioned Costs

No specific questioned costs were identified.

Recommendations

The Chancellor's Office should fully implement its corrective action plan by conducting site visits, desk reviews, or other monitoring procedures in accordance with its plan and issue management decisions on subrecipient audit reports within the required time frame.

Department's View and Corrective Action Plan

In response to the 2011-12 fiscal audit, the California Community Colleges made significant changes in their monitoring practices for the Carl D. Perkins federal awards. We implemented an A-133 audit monitoring and response system. All subrecipients that had CTE program findings were issued management decisions as all had complied and corrected their findings. However, it was not done within the required six months. A new shared file has been put in place with checks and balances to ensure that the subrecipients are issued management decisions within the required six months.

Additionally, the California community colleges Chancellor's Office developed a risk assessment monitoring tool and is implementing a new system. Division staff were trained over six sessions in monitoring the grants.

At this time the Chancellor's Office is implementing its corrective action plan by conducting site visits in accordance with its monitoring plan and issuing management decisions on subrecipient audit reports within the required time frame.

Contact

Debra Jones, Dean, Workforce and Economic Development Division, California Community Colleges Chancellor's Office

Implementation Date

March 2014

Reference Number:	2013-032
Federal Catalog Number:	84.027
Federal Program Title:	Special Education Cluster (IDEA)
Federal Award Number and Year:	H027A120116; 2012 H173A120120; 2012 H027A110116; 2011 H173A110120; 2011 H173A100120; 2010 H027A100116; 2010
Category of Finding:	Level of Effort – Maintenance of Effort
Type of Finding:	Instance of Noncompliance
State Administering Department:	Department of 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 1 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

During our audit for fiscal year 2011-12, we reported that Education lacked adequate controls to ensure it met maintenance of effort (MOE) requirements and did not request a waiver from the Federal Department of Education. In fiscal year 2012-13, Education again did not meet its MOE requirement by $93,351,516, nor did it request a waiver.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should monitor compliance throughout the grant period to ensure MOE requirements are being met. If Education cannot meet the MOE requirement, it should apply for a waiver from the U.S. Department of Education.

Department's View and Corrective Action Plan

Education has internal controls in place to ensure MOE requirements are met in accordance with federal regulations. However, the Legislature controls the appropriations that provide financial support for services to students with disabilities across state agencies, not Education. Education exercises 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.

Education monitors the budget process; if the proposed budget threatens the State's ability to meet federal Maintenance of Effort (MOE) for the Individuals with Disabilities Education Act (IDEA), Education promptly notifies the Legislature of the potential shortfall.

Throughout the year, Education obtains information regarding funds other state agencies provide directly to LEAs for special education services and any state funds other agencies directly pay to staff or contractors for the delivery of services pursuant to an Individualized Education Program. At this time, other state agencies have not finalized the actual expenditures for calculating fiscal year 2011–12 Special Education MOE. Once Education obtains the final expenditure data from the other state agencies, Education will assess compliance with federal MOE requirements. If the expenditure data demonstrates that state financial support did not meet MOE requirements, Education will request the necessary funding from the Legislature. However, if the Legislature does not provide Education with sufficient funding to meet MOE requirements, Education will seek a remedy from the federal Office of Special Education Program.

Contact

Fred Balcom, Director, Special Education Division

Implementation Date

July/August 2014

Reference Number	2013-033
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services - Vocational Rehabilitation Grants to States
Federal Award Number and Year:	H126A120005-12A; 2013 H126A1100005-11B; 2012 H126A100005C; 2011
Category of Finding:	Eligibility
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Rehabilitation (DOR)

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

During our audit for fiscal year 2011-12, we reported that DOR lacked adequate controls to determine applicant eligibility for services within the required 60-day time period and to develop an IPE within 90 days of eligibility determination. In fiscal year 2012-13, we found DOR continued to lack adequate controls and was not compliant with federal regulations. We tested 65 applicant cases and found the following:

- Thirteen cases were not deemed eligible within the 60-day time period.
- Four cases did not have an IPE developed within the 90-day time period.
- Seventeen cases had application dates in the file that did not agree to the application dates in the AWARE system. DOR relies on the application dates input into the AWARE system as a tracking mechanism to meet the 60-day and 90-day requirements.
- Six case files were missing either the Eligibility Determination form (DR 212) or the required signatures on the form.
- Four case files were missing either the IPE or the required signatures on the IPE.
- One case did not have a signature or date by the applicant or DOR counselor on the application form (DR-222).
- Ten cases lacked evidence of a supervisor's review to confirm that eligibility was properly determined.

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

Not determined.

Recommendations

DOR should strengthen its controls to assist caseworkers in managing and meeting eligibility determination and IPE deadlines. DOR should implement controls to ensure the dates entered into the AWARE system are accurate based on the supporting documents and forms and clarify the expectation that supervisors frequently review and document the review of those cases in which eligibility was determined solely by a senior counselor.

Department's View and Corrective Action Plan

The Department of Rehabilitation (DOR) agrees with the finding related to determining eligibility within 60-days, developing an Individualized Plan for Employment (IPE) within 90-days, discrepancies between application dates on the Vocational Rehabilitation (VR) Services Application (DR-222) compared to Accessible Web-based Activity Environment (AWARE), missing forms, and requisite signatures.

Corrective Action Plan:
In accordance with federal regulations, qualified VR counselors have the authority to determine eligibility and approve payments. DOR will strengthen its internal controls through standardized casework reviews of senior counselors with approval authority who determine eligibility and authorize payments to consumers.

DOR initiated and implemented a statewide monitoring plan for the 60-day eligibility and 90-day IPE timelines to address the findings from the Fiscal Year 2011-12 audit. The most recent reports indicate that monitoring has been effective in reducing the number of cases with eligibility not determined within 60-days of application and IPEs not developed within 90-days of eligibility determination. DOR Assistant Deputy Director, VR Employment Division, will assume oversight of this process.

- District Administrators (DA) and Team Managers (TM) received training on how to generate AWARE reports to identify consumers who have eligibility determinations and IPEs due in the next 30-days. DA implementation began after training was completed on December 3, 2013. TM training was completed on September 26, 2013 and January 29, 2014.

- DAs and TMs will review regulations and policies regarding requisite forms and signatures with applicable staff during monthly management team meetings.

- DOR will strengthen controls for the periodic review of casework for rehabilitation counselors with approval authority. TMs will conduct annual reviews of at least ten percent (10%) of the cases of a rehabilitation counselor with post-approval authority to ensure compliance with all applicable regulations. TMs will document the review findings, and per existing policy, take appropriate action for non-compliance.

- DOR will develop policy guidance to be released in Rehabilitation Administration Manual Chapter 30 (RAM 30) to include instructions on requisite documentation by DOR for cases where the application date on the DR 222 does not match the application date in AWARE.

- DOR will revise the AWARE Reference Guide to include instructions on requisite documentation by DOR for cases where the application date on the DR 222 does not match the application date in AWARE.

Contact

Mark Erlichman, Assistant Deputy Director, VR Employment Division

Implementation Date

July 1, 2014

Reference Number:	2013-034
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services - Vocational Rehabilitation Grants to States
Federal Award Number and Year:	H126A120005-12A; 2013 H126A1100005-11B; 2012 H126A100005C; 2011
Category of Finding:	Procurement
Type of Finding:	Instance of Noncompliance
State Administering Department:	Department of Rehabilitation (DOR)

Criteria

State Contracting Manual (SCM), Volume 2, 4.A1.0 Procurement Standards. Departments granted purchasing authority to conduct competitive procurements for non-IT goods will do so in a manner that promotes open, fair and equal competition among prospective suppliers.

State Contracting Manual (SCM), Volume 2, 4.C1.1 Non-IT Good Transactions Valued from $5,000.00 to $50,000.00. Achieving competition within this dollar range is defined as receiving responsive bids (each bid must meet all specifications and requirements) from at least two responsible bidders, if the solicitation is not advertised in the California State Contracts Register (CSCR). Although advertising in the CSCR is not required within this dollar range; it is recommended. Solicitations advertised in the CSCR may result in only one bid response. If the sole bid response is responsible and responsive then the contract may be awarded. The Buyer must document the procurement file with the justification to award to the sole bidder.

Condition

There was one incident where two DOR employees did not follow state procurement policies and procedures at one of its offices. These employees failed to solicit and obtain competitive bids from at least two responsible bidders when procuring maintenance services valued at $10,000. State policy requires competitive bids be obtained for purchases greater than $5,000, unless an exemption applies. Instead, these employees circumvented DOR's policies and procedures and directly contracted with the vendor.

Questioned Costs

$10,315

Recommendations

DOR should determine whether any additional controls and training are needed at the district office to ensure the State's procurement policies and procedures are followed.

Department's View and Corrective Action Plan

The Department of Rehabilitation (DOR) agrees that two DOR employees failed to solicit appropriate bids as required. However, DOR has existing controls in place to ensure State procurement policies and procedures are followed which aided in identifying this procurement noncompliance prior to the audit. Corrective actions were taken resulting in an employee being terminated. DOR will review existing procedures to determine whether any clarifications are needed.

Contact

Tina Watson, Chief, Financial Management Branch

Implementation Date

Employee terminated July 19, 2013
Determination of any clarifications to existing procedures, May 2014

Reference Number:	2013-035
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services - Vocational Rehabilitation Grants to States
Federal Award Number and Year:	H126A120005-12A; 2013 H126A1100005-11B; 2012 H126A100005C; 2011
Category of Finding:	Activities Allowed/Allowable Costs
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Rehabilitation (DOR)

Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – A*UDITS 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

DOR does not have adequate controls in place to approve expenditures charged to the federal grant. DOR was unable to provide evidence of review for six of 25 central/internal service items tested and one of 25 indirect costs tested. Failure to review supporting documentation for expenditures increases the risk of federal funds spent on unallowed activities or costs.

Questioned Costs

No specific questioned costs were identified.

Recommendations

DOR should strengthen its controls to ensure expenditures are properly reviewed for allowable activities and costs and approval is documented.

Department's View and Corrective Action Plan

The Department of Rehabilitation (DOR) has controls in place to approve expenditures charged to the federal grant, however, agrees that expenditure approvals for certain types of invoices were not evidenced on the invoice via a wet signature. All invoices approved by Central Office Accounting are evidenced as approved through an electronic payment approval in its accounting system. DOR will review existing procedures and strengthen the evidence of its approval process.

Contact

Tina Watson, Chief, Financial Management Branch

Implementation Date

March 14, 2014

Reference Number:	2013-036
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services - Vocational Rehabilitation Grants to States
Federal Award Number and Year:	H126A120005-12A; 2013 H126A1100005-11B; 2012 H126A100005C; 2011
Category of Finding:	Level of Effort – Maintenance of Effort
Type of Finding:	Instance of Non-Compliance
State Administering Department:	Department of Rehabilitation (DOR)

Criteria

TITLE 34 – EDUCATION, CHAPTER 3 – OFFICE OF SPECIAL EDUCATION AND REHABILITATIVE SERVICES, DEPARTMENT OF EDUCATION, Part 361 - STATE VOCATIONAL REHABILITATION SERVICES PROGRAM, Subpart C - Financing of State Vocational Rehabilitation Programs, Section 361.62 - Maintenance of effort requirements.

(a)General requirements.

(1) The Secretary reduces the amount otherwise payable to a State for a fiscal year by the amount by which the total expenditures from non-Federal sources under the State plan for the previous fiscal year were less than the total of those expenditures for the fiscal year 2 years prior to the previous fiscal year. For fiscal year 2001, a State's maintenance of effort level is based on the amount of its expenditures from non-Federal sources for fiscal year 1999. Thus, if the State's non-Federal expenditures in 2001 are less than they were in 1999, the State has a maintenance of effort deficit, and the Secretary reduces the State's allotment in 2002 by the amount of that deficit.

(2) If, at the time the Secretary makes a determination that a State has failed to meet its maintenance of effort requirements, it is too late for the Secretary to make a reduction in accordance with paragraph (a)(1) of this section, then the Secretary recovers the amount of the maintenance of effort deficit through audit disallowance.

Condition

DOR did not meet its maintenance of effort requirement by $821,488. This appears to be a result of the downturn in the economy causing a decline in the State's general fund resources. As a result, DOR could be subject to a reduction of federal funding.

Questioned Costs

No specific questioned costs were identified.

Recommendations

DOR should ensure it meets MOE requirements.

Department's View and Corrective Action Plan

The Department of Rehabilitation (DOR) agrees that Maintenance of Effort (MOE) requirements were not met for Federal Fiscal Year (FFY) 2011 due to California experiencing a serious economic downturn that resulted in a general reduction of programs within the State. A MOE waiver for FFY 2011 will be submitted following instruction from the United States Department of Education (US ED)/Rehabilitation Services Administration (RSA).

Contact

Tina Watson, Chief, Financial Management Branch

Implementation Date

Upon instruction from the US ED/RSA

Reference Number:	2013-037
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A100013-12; 2012 U282A100013-11; 2011 U282A100013A; 2010
Category of Finding:	Period of Availability
Type of Finding:	Instance of Noncompliance
State Administering Department:	California Department of Education (Education)

Criteria

TITLE 34 – EDUCATION, SUBTITLE A – ADMINISTRATIVE OFFICE OF THE SECRETARY, DEPARTMENT OF EDUCATION, PART 80 – UNIFORM ADMINSTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS, SUBPART C – POST-AWARD REQUIREMENTS, Section 80.23 – Period of Availability of Funds

(a) General. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligations of the subsequent funding period.

Condition

Education obligated federal funds totaling $517,500 to one charter school outside the period of availability. The fiscal year 2011-12 Charter Schools grant agreement stated the period of availability was from August 1, 2011 to July 31, 2012. The charter school originally applied for funding during fiscal year 2011-12; however, its application was denied due to low enrollment projections and the charter requested a second review. The charter school was approved in fiscal year 2012-13 but since its application was open longer than one year as specified by the federal grant, it would not have been eligible for approval at that time. To fund the charter school, Education reopened its original application and obligated and paid the full three-year grant totaling $517,500 in one payment, eight months after the period of availability. Failure to obligate funds in the period of availability increases the risk that amounts may be owed to the Federal government.

Questioned Costs

$517,500

Recommendations

Education should strengthen its process to ensure funds are obligated from the Charter Schools grant within the period of availability.

Department's View and Corrective Action Plan

Education accepts the recommendation. Education has controls in place to reasonably assess grantees' sustainability and to ensure Charter School's funding is obligated within the Charter Schools grant's period of availability. The example cited by the auditors was a situation in which Education identified a potential fiscal risk with the charter school's enrollment projections, which resulted in a delay in funding. Pursuant to the Public Charter Schools Grant Program (PCSGP) Request for Applications (RFA), if a grantee is concerned that it will not meet the enrollment requirements, in lieu of meeting this requirement, Education will consider a budget report submitted by the grantee that attests to the sustainability of the school beyond the duration of the grant.

Upon denial of the grant due to low enrollment projections, the charter school requested that Education consider a fiscal review to ascertain the school's sustainability. Based on the initial fiscal information provided by the charter school, Education concluded that the school was ineligible for the grant due to indicators that questioned the school's fiscal solvency. Subsequently, the charter school provided its audited financial information. After Education's review of the audited financial information, the school was reassessed as being sustainable for the duration of the grant. Consequently, the application that the charter school submitted within being open less than a year was approved for funding.

Education maintains that circumstances regarding the charter school in question were necessary to ensure the proper approval, resolution, and disbursement of PCSGP funding. However, Education has revised the timelines for future application reviews and approvals to prevent funding from being disbursed outside the period of availability. In light of the circumstances surrounding this condition, Education will contact the U.S. Department of Education to confirm whether a waiver is necessary.

Contact

Julie Russell, Charter Schools Division Director

Implementation Date

Fiscal Year 2013-14

Reference Number:	2013-038
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A100013-12; 2012 U282A100013-11; 2011 U282A100013A; 2010
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency
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

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

Education does not have adequate controls in place to ensure the accuracy and allowability of costs submitted by subrecipients on the quarterly expenditure reports. Subrecipients submit quarterly reports to show expenditures incurred to date and request from Education the next apportionment of federal funding. One of 24 subrecipient expenditure reports selected for testing was not reviewed prior to disbursing the charter school its next apportionment of federal funds. Failure to review the expenditure reports increases the risk that a subrecipient may spend federal funds on unallowed activities or costs.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should strengthen controls to review quarterly expenditure reports submitted by the charter schools prior to disbursing the next apportionment.

Department's View and Corrective Action Plan

Education has addressed this finding with the 2012–13 Fiscal Year (FY) Public Charter Schools Grant Program (PCSGP) subgrantee applicants. Beginning with the 2012–13 FY PCSGP applicants, Education instituted the following Corrective Action Plan:

Budget/Expenditure Approval Process

- All PCSGP applicants are required to submit a narrative budget and summary budget that addresses all expenditures for each year of the grant.
  - Three-year grant: 1 Planning Year & 2 Implementation Years
  - Two-year grant: 2 Implementation Years
- All narrative and summary budgets are reviewed by a PCSGP program consultant for allowable expenditures. If unallowable expenditures are identified, the narrative and summary budget forms are returned to the subgrantee for revisions. Once all expenditures have met the allowability criteria, the PCSGP program consultant approves the PCSGP subgrantee budget and places it in the subgrantee file.

Budget/Expenditure Reporting Process

- Beginning with FY 2013–14, all subgrantees are required to use the Quarterly Expenditure Reporting (QER) forms.
- All PCSGP subgrantees that used the on-line Quarterly Benchmark Report (QBR) were required to submit a budget narrative and budget summary form for the remainder of their respective grant.
- QERs are reviewed by PCSGP program analysts and program consultants for accuracy and adherence to the approved budget narrative and summary.
  - If the QER is accurate and correct, the PCSGP program consultant signs the approved QER and a quarterly payment is processed to the subgrantee.
  - If there are inaccuracies identified in the QER, the subgrantee is contacted by the PCSGP program consultant and the inaccuracies and unallowable expenditures are reviewed with the subgrantee. Once the inaccuracies and/or unallowable expenditures are corrected, the PCSGP program consultant signs the approved QER and a quarterly payment is processed.

If an identified inaccuracy in an object code is greater than 10 percent of the approved budget and a change needs to be made to the approved budget, the subgrantee is required to submit a PCSGP Budget/Program Change Form. The PCSGP Budget/Program Change Form is reviewed by a PCSGP program consultant. If the requested change is allowable, the PCSGP program consultant signs the approved change form and the subgrantee must revise the QER to reflect the approved change. The PCSGP program consultant signs the approved QER and a quarterly payment is processed.

Contact

Julie Russell, Charter Schools Division Director

Implementation Date

The budget/expenditure approval process was implemented in October 2012 with the 2012–13 PCSGP Request for Applications.

The budget/expenditure reporting process was implemented in FY 2013–14, Quarter 1.

Reference Number:	2013-039
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)
Federal Catalog Number:	84.388 (ARRA)
Federal Program Title:	School Improvement Grant Cluster
Federal Award Number and Year:	S388A090005A; 2009
Federal Catalog Number:	84.410
Federal Program Title:	Education Jobs Fund
Federal Award Number and Year:	S411A100005-10A; 2010 S410A100005; 2010

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

During our audit for fiscal year 2011-12, we reported that Education did not have an adequate process or controls in place to ensure accuracy of the quarterly Section 1512 report prior to submission for the School Improvement Grant Cluster. Similar to the finding in 2011-12, Education prepares the report from information maintained by program personnel but that information is not reconciled to accounting records, such as the general ledger. In addition, the amount reported as disbursed to one local educational agency for the School Improvement Grant was understated by $75,821. Lack of adequate controls over Section 1512 reports increases the risk that inaccurate or incomplete information will be reported to the federal government.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Education should strengthen its process over preparation of reports to ensure the reports are prepared based on expenditures in the general ledger and reviewed for accuracy prior to submission.

Department’s View and Corrective Action Plan

Education accepts the recommendation. The reporting error identified by the auditors was corrected on November 13, 2013. Education will ensure that the final report to the federal government reconciles with Education’s accounting records. The ARRA School Improvement grant period is over and the LEA Section 1512 reporting period ended on January 31, 2014.

Contact

Carol Bingham, Senior Fiscal Policy Advisor Government Affairs Division

Implementation Date

November 2013

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number	2013-040
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 Year:	1301CA1401; 2013 1201CA1401; 2012 1201CA1404; 2012

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Number and Year:	1301CA1407: 2013 1201CA1407; 2012

Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families (TANF) Cluster
Federal Award Number and Year:	G-1302CATANF; 2013 G-1202CATANF; 2012

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

During our fiscal year 2011-12 audit, we reported that Social Services did not comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for its federally funded programs. Social Services is in the process of implementing its FFATA reporting process, but failed to submit the fiscal year 2012-13 FFATA reports.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Social Services 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

Social Services agrees with the audit finding. Since the original audit finding for fiscal year 2011-12, Social Services developed a corrective action plan and has been working with the respective federal agencies and subaward recipients to comply with all FFATA reporting requirements for mandatory grants. This audit finding has been partially corrected based on guidance received by the Administration for Children and Families Region IX. The Department anticipants full compliance by May 2014.

Contact

Didi Okamoto, Chief, Fiscal Systems and Accounting Branch

Implementation Date

May 2014

Reference Number:	2013-041
Federal Catalog Number:	93.772, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1305CA5MAP; 2013 05-1205CA5MAP; 2012 1205CAARRA; 2012
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 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

State automated welfare systems (SAWS) were implemented 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 benefits on behalf of participants for Medicaid.

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 monitoring these systems to ensure they meet the federal requirements necessary to ensure compliance, including federal compliance related to eligibility determination and redetermination.

Health Care Services communicates to counties information required by federal regulations through the State Plan, alert letters, and other agreements. However, as identified during our fiscal year 2011-12 audit, 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 counties as to how federal compliance requirements related to eligibility were to be addressed in county OMB Circular A-133 audits. Health Care Services also did not report subrecipient expenditures for fee-for-service amounts and managed care premiums to counties. In other words, the OMB A-133 Compliance Supplement guidance on split eligibility does not apply in California. Instead, the county auditor is responsible for meeting internal control and compliance objectives for eligibility.

During fiscal year 2012-13, Health Care Services began to evaluate how to communicate to counties and auditors their responsibilities under OMB Circular A-133; however, no changes were made. As part of its evaluation, Health Care Services began to consider implication of the federal Patient Protection and Affordable Care Act (PPACA), which expands Medicaid coverage and simplifies eligibility requirements to be based on financial and nonfinancial criteria including income and citizenship/immigration status for a majority of beneficiaries.

Health Care Services partnered with the California Health Benefit Exchange (Covered California) to implement the State’s health benefit exchange or marketplace, as required by the PPACA. Covered California is a related organization to the State of California and not considered a department or component unit.

Through Covered California, the California Healthcare Eligibility, Enrollment and Retention System (CalHEERS) was deployed on October 1, 2013 to meet the requirements of the PPACA. CalHEERS was designed to determine eligibility based on modified adjusted gross income and citizenship, immigration status, incarceration status and other health care coverage among others. The county is also responsible for determining eligibility in certain circumstances, including those not determined based on modified adjusted gross income. In addition, counties continue to be responsible for redeterminations, and case management for all beneficiaries.

Even with the changes to eligibility under the PPACA, the OMB A-133 Compliance Supplement guidance on split eligibility still does not apply in California. The counties and Covered California perform all parts of eligibility determination. As a result, the county auditor is responsible for meeting internal control and compliance objectives for eligibility.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Health Care Services should work with relevant parties, including the Centers for Medicare and Medicaid, counties, and Covered California, to ensure relevant eligibility control and compliance objectives are subject to audit at the county. Health Care Services should report fee-for-service amounts and managed care premiums to counties as subrecipient expenditures for inclusion on the county Schedule of Expenditures of Federal Awards.

Department's View and Corrective Action Plan

DHCS agrees that the automated welfare systems (SAWS) are owned, operated and maintained by the respective 58 counties throughout the state. However, DHCS contends that existing federally mandated Medi-Cal eligibility quality control reviews performed by DHCS, along with additional reviews that DHCS is planning to implement in FY 2015/16, is more than sufficient to meet county internal control and compliance objectives for eligibility. The fact that DHCS is performing the reviews instead of county auditors should not preclude the objectives from being met.

DHCS is currently working closely with the Centers of Medicare and Medicaid Services (CMS) to obtain approval to implement a series of four new Medicaid eligibility quality control pilots over the next three years that are designed to replace pre-ACA quality control requirements (Medi-Cal Eligibility Quality Control and Payment Error Rate Measurement programs). The new pilot programs will consist of DHCS staff re-performing eligibility determinations from a random sample that will identify potential errors made by SAWS and/or county eligibility workers.

In addition, pursuant to Senate Bill 28 (Hernandez, Chapter 4, Statutes of 2013), DHCS is required to implement a new budgeting methodology for county administrative costs that DHCS plans to implement in FY 2015/16. The new budgeting methodology is intended to address the changes in eligibility determination rules and processes resulting from implementation of the ACA. A core element of the new budgeting methodology is to utilize state auditors from DHCS' Audits and Investigations Division, with assistance from a private contractor, to perform county reviews, including, time studies to assess how long it takes county eligibility workers to perform various tasks under new ACA rules. The data obtained by the auditors will be used as part of the new budgeting methodology. DHCS suggests the auditor of the State continue to audit Medi-Cal eligibility performed by the SAWS/counties for FY 2014/15 and close out this audit finding based on implementation of the DHCS review processes described above.

Contact

Robert Sugawara, Chief, Program Review Branch, Medi-Cal Eligibility Division

Implementation Date

Ongoing and FY 15/16

Reference Number:	2013-042
Federal Catalog Number:	93.772, 93.775, 93.777, 93.778
Category of Finding:	Activities Allowed/Allowable Costs
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Health Care Services (Health Care Services)
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1305CA5MAP; 2013 05-1205CA5MAP; 2012 1205CAARRA; 2012

Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program
Federal Award Number and Year:	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

During our fiscal year 2011-12 audit, we reported that certain information security and change management controls over the California Medicaid Management System (CA-MMIS) were not operating effectively. Health Care Services utilizes a third-party fiscal intermediary (FI) to adjudicate fee-for-service claims and effective October 1, 2011 a new FI was engaged.

Health Care Services obtained a Service Organization Control (SOC1) report over logical security, change management, backup and restoration, and production job processing functions of CA-MMIS for the period from July 1, 2012 through June 30, 2013. The SOC1 contained a qualified opinion as controls over job processing and system access were found to be not operating effectively for the period. Ineffective controls over job processing and system access could result in inappropriate claims being processed.

Specifically, the SOC1 report identified the following:

- The FI does not maintain formal policy documentation to assure proper processing of jobs through documentation of job description, job dependencies, job escalation, and restart procedures.
- Controls related to handing deviations in job processing were not consistently followed.
- Management approvals prior to setting up access in mainframe and mid-range systems supporting CA-MMIS were not consistently obtained and documented.
- Controls related to removing/disabling of user access after the use is terminated were not consistently followed.
- Periodic review of access appropriateness of users with access to the Mainframe and Mid-range systems supporting CA-MMIS were not consistently performed.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Health Care Services should work with the FI to develop a corrective action plan to address the deficiencies that were noted in the SOC1 report for job processing and system access.

Department's View and Corrective Action Plan

DHCS agrees with the Service Organization Control (SOC1) report referenced by KPMG in their finding. When the SOC1 report was released to CAMMIS, CAMMIS issued a request for a corrective action plan to Xerox on December 17, 2013. DHCS received a response from Xerox via FI Letter T4092 on February 18th, 2014. DHCS CAMMIS is currently reviewing FI Letter T4092, along with monitoring Xerox's progress toward achieving security improvements. DHCS will complete its review and respond by March 21, 2014

Contact

Cynthia Guest, Chief IT Management Branch, CAMMIS

Implementation Date

December 31, 2014

Reference Number:	2013-043
Federal Catalog Number:	93.772, 93.775, 93.777, 93.778
Category of Finding:	Activities Allowed/Allowable Costs
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Health Care Services (Health Care Services)
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1305CA5MAP; 2013 05-1205CA5MAP; 2012 1205CAARRA; 2012

Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program
Federal Award Number and Year:	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 the CAPMAN system to adjudicate managed care provider monthly payments based on the number of beneficiaries enrolled during the period. We found that certain program access controls were not operating effectively during fiscal year 2012-13. Failure to properly implement controls could result in inappropriate users gaining access to the system and failure of application controls embedded in the system.

Specifically, we identified the following:

- For one of eight new users tested, Health Care Services was unable to provide support for the approval of the access granted.

- Three of the 24 users with access to CAPMAN had been terminated and, therefore, should no longer have access to the system.

- Two of 60 administrators with access to CAPMAN servers had transferred to another department or been terminated and no longer required access.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Health Care Services should improve its policies and procedures over system access. Specifically, Health Care Services should:

1. Maintain support documenting approvals for access granted.

2. Identify individuals who have been terminated and promptly remove their system access.

3. Identify administrators who have transferred to another department or been terminated and promptly remove their system access.

Department's View and Corrective Action Plan

DHCS agrees with the recommendation, "Health Care Services should improve its policies and procedures over system access," and is carrying out the following Corrective Action Plan:

1. Create and follow a new process, "Annual review of system access to CAPMAN."

Implementation Date

The first review was completed in October 2013, which resulted in the removal of access rights for 20 individuals who no longer had a business need to access CAPMAN. In the process of documenting the process in *820/834 Production Support, Roles and Responsibilities.*

2. Create a new form for managers to formally request access additions, removals, and changes. Include level/type of access requested on the form. Store the forms for future retrieval and documentation purposes

Implementation Date

1. Completed in September 2013. *Documented in 820/834 Production Support, Roles and Responsibilities.*

2. March 2014. Please note that corrective actions have already begun. The only remaining item, targeted for completion in March 2014, is to update the *820/834 Production Support, Roles and Responsibilities* document to include a description of the annual review process.

Contact

Deepa Pochiraju, Chief HIPAA Transactions Section, Office of HIPAA Compliance

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Reference Number:	2013-044
Federal Catalog Number:	93.772, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1305CA5MAP; 2013 05-1205CA5MAP; 2012 05-1205CAARRA; 2012 05-1105CAARRA; 2011 05-1105CA5MAP; 2011
Category of Findings:	Eligiblity; Subrecipients Monitoring
Type of Finding:	Significant Deficiency and 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 ELIGIBILTY 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

Counties did not have adequate controls to ensure eligibility determinations and redeterminations were appropriate and timely. 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. An aid code is generated for each beneficiary which details the beneficiary's scope of benefits and a share of cost, if required. The consortium systems interface with the Health Care Services system that holds eligibility information, Medicaid Eligibility Database System (MEDS). Health Care Services uses aid code information in MEDS to determine the allowability of claims by confirming the beneficiary's eligibility.

We tested 100 beneficiaries and reperformed the counties' eligibility determinations and redeterminations and found:

- One instance where a county did not perform the redetermination.

- One instance where a county case worker adjusted the beneficiary's eligibility determination benefit calculation (EDBC) in May 2013 and overrode the previous EDBC dating back to September 2012 instead of adjusting the EDBC on a go-forward basis as of May 2013. As a result, the beneficiary's aid code for the period from September through April 2013 was incorrect. We found that the change in aid codes did not impact the beneficiary's level of benefits in this instance.

Total direct federal Medicaid expenditures made by the Health Care Services for provider payments and managed care amounted to $27 billion for the fiscal year 2012-13.

Questioned Costs

$2,948

Recommendations

Health Care Services should improve policies, procedures, and monitoring for county eligibility determinations. Health Care Services should reissue guidance to counties to:

1. Ensure that redeterminations are made in a timely manner.

2. Ensure EDBC are updated appropriately.

Department's View and Corrective Action Plan

DHCS agrees with the recommendations. In addition, DHCS has validated and confirmed the findings and will reissue guidance to counties as recommended.

Contact

Robert Sugawara, Chief, Program Review Branch, Medi-Cal Eligibility Division

Implementation Date

Fall 2014

Reference Number:	2013-045
Federal Catalog Number:	93.772, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1305CA5MAP; 2013 05-1205CA5MAP; 2012 05-1205CAARRA; 2012 05-1105CAARRA; 2011 05-1105CA5MAP; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and 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.

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. 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.

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

During our audit for fiscal year 2011–12, we reported that Health Care Services did not have adequate policies and procedures in place to monitor subrecipients in accordance with federal requirements. In fiscal year 2012-13, we found Health Care Services implemented some corrective action but continues to lack adequate policies and procedures to monitor subrecipients. Health Care Services provides services under the Medicaid 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. Funds are also passed through to local education consortiums and other nonprofit organizations for reimbursement of expenditures for Medicaid programs and administrative costs. Health Care Services disbursed $1.96 billion to subrecipients for county and school-based administrative activities in fiscal year 2012-13.

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 found the following:

- Health Care Services does not have policies and procedures in place to ensure that DUNS numbers are obtained from its subrecipients prior to awarding of federal funds. Failure to obtain DUNS numbers increases the risk that subrecipients may spend federal funds for unallowable purposes or incorrectly reporting subawards.

- 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, we identified 9 of the 28 local government agencies or local education consortiums that are part of the school-based program which had no site visit or desk review performed within the last three years. Lack of adequate monitoring increases the risk that Medicaid funds may not be spent for an allowable purpose.

- Health Care Services does not have policies and procedures in place to obtain OMB Circular A-133 audit reports from local education consortiums and nonprofit organizations. As a result, Health Care Services does not determine whether appropriate and timely corrective action has been taken with respect to Medicaid findings.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Health Care Services should implement policies and procedures to ensure that it properly monitors subrecipients. Health Care Services should:

1. Develop policies and procedures to obtain DUNS numbers prior to awarding federal funds.

2. Ensure that site visits are performed in accordance with department policy.

3. Develop policies and procedures to ensure OMB Circular A-133 audit reports for all subrecipients reporting federal funds of more than $500,000 are received and management decisions are issued as necessary.

Department's View and Corrective Action Plan

1. Develop policies and procedures to obtain DUNS numbers prior to awarding federal funds.

DHCS Response: DHCS agrees with the recommendation.

DHCS' Medi-Cal Administrative Activities (MAA) program contract agreements do no currently contain relevant award language for obtaining contractors data universal numbers (DUNS) prior to the awarding of federal funds. DHCS will add contract language in the Exhibit B, Budget Detail and Payment Provision section to require Local Governmental Agencies (LGAs) and Local Educational Consortiums (LECs) to submit the appropriate documentation to Health Care Services indicating their DUNS number prior to final execution of the contract agreement. The MAA program will forward a copy to DHCS accounting section prior to the payment of invoices.

DHCS will also revise contract language to require LGAs and LECs to include this language in contracts with their subrecipients and/or vendors. LGA/LECs compliance with this directive will be monitored and verified during onsite visits.

2. Ensure that site visits are performed in accordance with department policy.

DHCS Response: DHCS agrees with the recommendation.

In April 2011, DHCS imposed travel restrictions and all site visits were issued a directive to decease. 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. The School-Based MAA (SMAA) program has resumed to conducting site visits and/or desk reviews in accordance with department policy during the 2012/13 Fiscal Year. However, due to the implementation of the current deferral on the SMAA program and the development of a new statewide claiming plan and time survey methodology to be in compliance with the Office of Management and Budget A-87, the SMAA program was not able to perform the nine counties site visits and/or desk reviews (Sonoma, Orange, Fresno, Riverside, San Diego, San Luis Obispo, Santa Cruz, Solano, and City of Pasadena). The SMAA program is anticipating on completing site visits and/or desk reviews on all nine counties by June 30, 2014.

3. Develop policies and procedures to ensure OMB Circular A-133 audit reports for all subrecipients reporting federal funds of more than $500,000 are received and management decisions are issued as necessary.

DHCS Response: DHCS agrees with the recommendation.

The Audits and Investigation 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. The State Controller's Office (SCO) has a Single Audit oversight responsibility and preparing audit-finding reports in accordance with the A-133 Single Audit Report. A&I will establish procedures to ensure that it contacts the SCO in a timely manner to secure A-133 Single Audit 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 Audit Reports of the LEA who received Medi-Cal Billing Option funds from the SCO starting with the fiscal year ended June 30, 2013, and include the reports in our tracking, monitoring, and follow-up system.

Contact

Michelle Kristoff, Chief, Administrative Claiming and Local School Services Branch, Safety Net Financing Division

Implementation Date

July 1, 2014

Reference Number:	2013-046
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B)
Federal Award Number and Year:	X07HA12778; 2013 X07HA12778; 2012 X09HA24703; 2012 X08HA19011; 2012 X09HA20246; 2012
Category of Finding:	Cash Management
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 215—UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND AGREEMENTS WITH INSTITUTIONS OF HIGHER EDUCATION, HOSPITALS, AND OTHER NON-PROFIT ORGANIZATIONS (OMB CIRCULAR A-110), Subpart C—Post-Award Requirements, Financial and Program Management

§ 215.22 Payment.

(g) To the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments.

Condition

Public Health does not have proper controls in place to ensure that rebate income is disbursed prior to requesting reimbursement from the Federal government. Rebate income is periodically used to fund expenditures; however, no tracking is performed to ensure rebate income is utilized prior to requesting Federal funds. Failure to utilize rebate income may result in inaccurate or untimely drawdowns of Federal funds.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Public Health should strengthen its policies and procedures over cash management to ensure that individuals are knowledgeable of the Federal requirements and controls are implemented to use rebate income prior to requesting reimbursement from the Federal government.

Department's View and Corrective Action Plan

CDPH agrees with this recommendation and has fully implemented it.

CDPH agrees we should have policies and procedures over cash management to ensure that individuals are knowledgeable of the Federal requirements and controls are implemented to ensure rebate income is disbursed prior to requesting reimbursement from the Federal government.

In November 2012, the Health Resources Services Administration (HRSA) notified CDPH's Office of AIDS (OA) that grantees are required to spend rebate funds prior to drawing down Ryan White grant funds. On November 29, 2012, OA requested guidance from its HRSA Project Officer regarding this policy. Due to fiscal processes established prior to HRSA's notice, OA had spent most of the 2012 federal funds from July 2012 through December 2012. In January 2013, OA's HRSA Project Officer verbally informed OA that it could continue to maintain a rebate fund reserve. However, in June 2013, HRSA verbally informed OA that it must use rebate funds prior to spending federal funds.

Effective July 1, 2013, OA modified its fiscal processes and now monitors weekly cash balance reports for the ADAP Rebate Fund (Special Fund 3080). OA verbally notified staff on November 20, 2012 of this change, followed by a procedure memo documenting this change. In December 2013, OA's HRSA Project Officer provided verbal approval for OA to keep rebate funds available to cover the Insurance Assistance Programs. When the rebate fund cash balance is approximately $2-$3 million, OA uses federal ADAP funds. On January 23, 2014, OA issued a memo to AIDS Drug Assistance Program (ADAP) Branch Fiscal Staff documenting the new procedure.

Contact

Niki Dhillon, ADAP Branch Chief

Implementation Date

July 1, 2013

Reference Number:	2013-047
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B)

Federal Award Number and Year:	X07HA12778; 2013 X07HA12778; 2012 X09HA24703; 2012 X08HA19011; 2012 X09HA20246; 2012
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

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

Public Health does not have adequate controls over subawards. Public Health did not properly communicate the Catalog of Federal Domestic Assistance (CFDA) title and number for the nine subrecipients tested. Failure to properly communicate award information increases the risk that subrecipients may inappropriately spend federal funds or fail to comply with federal regulations. Public Health passed through $29.4 million to subrecipients during fiscal year 2012-2013.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Public Health should improve its processes to communicate the CFDA title and number to subrecipients.

Department's View and Corrective Action Plan

CDPH agrees it should have processes to communicate the CFDA title and number to subrecipients.

CFDA number and title will be displayed on the scope of work documents that are sent to the county when the current scope of work is amended July 1, 2014 for 2014-2015.

Contact

Peter Domich, Fiscal Manager

Implementation Date

July 1, 2014

Reference Number:	2013-048
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health
Federal Award Number and Year:	3B09SM010005-13; 2013 2B09SM010005-12; 2012
Category of Finding:	Subrecipient Monitoring; Special Tests and Provisions
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

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 Number 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.

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE ADMINISTRATION, Sec. 7502. Audit requirements; exemptions:

(f)(2) Each pass-through entity shall:

(C) 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; and,

(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.

TITLE 42 – THE PUBLIC HEALTH AND WELFARE, Subpart III – General Provisions, Sec. 300x-53. Additional requirements;

(a) In general

A funding agreement for a grant under section 300x or 300x–21 of this title is that the State involved will—

(1)(A) for the fiscal year for which the grant involved is provided, provide for independent peer review to assess the quality, appropriateness, and efficacy of treatment services provided in the State to individuals under the program involved; and

(B) ensure that, in the conduct of such peer review, not fewer than 5 percent of the entities providing services in the State under such program are reviewed (which 5 percent is representative of the total population of such entities);

Condition

Health Care Services does not have adequate policies and procedures to monitor its Block Grants for Community Mental Health program (Mental Health) subrecipients and ensure the required peer reviews are performed in accordance with federal requirements. Failure to properly monitor subrecipients and perform peer reviews increases the risk that federal monies will be paid for unallowable costs and that programs may not meet quality, appropriateness, and efficacy of treatment services standards of the state. In fiscal year 2012-13 the Mental Health program expended $67.6 million, with $67 million passed through to 57 county subrecipients.

The Department of Mental Health was consolidated into Health Care Services effective July 1, 2012. Health Care Services did not obtain DUNS numbers from its Mental Health subrecipients prior to awarding federal funds. In addition, Health Care Services did not perform performance or fiscal monitoring during fiscal year 2012-13 through site visits, limited scope audits, or other means. Finally, Health Care Services did not perform any peer reviews during fiscal year 2012-13.

Questioned Costs

No specific questioned costs were identified.

Recommendations

Health Care Services should implement policies and procedures to ensure it properly monitors subrecipients and performs required peer reviews. Health Care Services should:

1. Obtain DUNS numbers from Mental Health program subrecipients prior to approving the subaward.

2. Perform site visits, limited scope audits, or other monitoring of counties.

3. Perform peer reviews in accordance with federal regulations.

Department's View and Corrective Action Plan

Recommendation One – Obtain DUNS numbers from Mental Health program subrecipients prior to approving subaward.

The Department of Health Care Services (DHCS) agrees with the recommendation. DHCS will implement this in its State Fiscal Year (SFY) 2014-15 Planning Estimate and Renewal Application for the Mental Health Block Grant, (MHBG). The application instructions will require all participating

MHBG counties to provide their DUNS Number within their county application. Renewal Applications that do not contain a DUNS number will not be approved and those counties will not receive an allocation. Implementation date is April 2014. DHCS plans to include language in the SFY 2014-15 Renewal Application that will require county mental health departments to provide a DUNS number. The Planning Estimate and Renewal Application are set for release in March 2014.

Recommendation Two – Perform site visits, limited scope audits, or other monitoring of counties.

DHCS agrees with the recommendation. DHCS is working to update its existing site review protocols to include a request to review financial information. After completing its revision of the site review protocol, DHCS will conduct site visits of the MHBG programs in Sacramento County, Placer County, and San Joaquin County prior to the end of Fiscal Year 2013-14. DHCS will conduct site reviews of the MHBG program in three counties on an annual basis in subsequent fiscal years. These site reviews will include a review of expenditures charged to the MHBG. DHCS plans to complete its site review protocol by the end of March 2014. DHCS plans to conduct a site review in Sacramento County in April 2014; a site review in Placer County in May 2014; and a site review of San Joaquin County in June, 2014. DHCS plans to incorporate more than three site visits in subsequent fiscal years.

Recommendation Three – Perform peer reviews in accordance with federal regulations.

DHCS agrees with the recommendation. Federal regulations require that the State conduct peer reviews of not less than 5% of the entities providing mental health services in the State on an annual basis. DHCS will perform peer reviews in accordance with federal regulations to decrease the risk of federal dollars being utilized for unallowable costs and to ensure program quality, appropriateness, and efficacy of treatment service standards of the state. These peer reviews are expected to be integrated with the site reviews described under recommendation two. DHCS will request the mental health director from a neighboring county identify a county employee who is familiar with the MHBG to participate in the site review team. Peer reviews will be implemented at the same time that site reviews are implemented.

Contact

Kimberly Wimberly, Chief, Grants Management Unit

Implementation Date

April 2014

See above.

Reference Number:	2013-049
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse
Federal Award Number and Year:	2B08TI010005-13; 2013 3B08TI010005-12; 2012 3B08TI010005-11S5; 2011
Category of Finding:	Allowable Costs
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 2 GRANTS AND AGREEMENTS, PART 225 – COST PRINCIPLES FOR STATE, LOCAL, AND INDIAN TRIBAL GOVERNMENTS (OMB CIRCULAR A-87), APPENDIX a – GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS.

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

    a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

    b. Be allocable to Federal awards under the provisions of 2 CFR part 225.

    c. Be authorized or not prohibited under State or local laws or regulations.

    d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

    e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.

    f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

    g. Except as otherwise provided for in 2 CFR part 225, be determined in accordance with generally accepted accounting principles.

    h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.

    i. Be the net of all applicable credits.

    j. Be adequately documented

Condition

Health Care Services did not have adequate policies and procedures to ensure documentation was maintained during the transition of the Department of Alcohol and Drug Programs (ADP). On July 1, 2013, ADP was combined into Health Care Services which took over management and operations of all ADP programs. We tested 40 payroll costs charged to the grant and found seven in which the amount tested did not agree to the expenditure detail provided by Health Care Services. Health Care Services informed us that the differences were related to manual adjustments which may have related to other individuals recorded in the lump sum detail they provided. However, given the transition from ADP, records were not organized in a manner that would allow the adjustments to be easily identified and to locate supporting documentation. The differences totaled $1,197 of $168,442 tested. Payroll for the program was $5.6 million.

Questioned Costs

$1,197

Recommendations

Health Care Services should ensure it implements its own policies and procedures so that books and records are available to support grant expenditures.

Department's View and Corrective Action Plan

DHCS agrees with the recommendation to implement its own policies and procedures so the records are available to support grant expenditures.

On July 1, 2013, the Department of Alcohol and Drug Prevention (ADP) transitioned over to DHCS. DHCS immediately began to implement DHCS policies and procedures to ensure that adequate documentation is prepared and maintained to support allowable costs. It should be noted that during the 2012 audit of the Medicaid Cluster-Medical Assistance Program (Medi-Cal), that no findings were presented to DHCS regarding inadequate supporting documentation.

Contact

John Cathey, Chief, Accounting

Implementation Date

July 1, 2013

Reference Number:	2013-050
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse
Federal Award Number and Year:	2B08TI010005-13; 2013 3B08TI010005-12; 2012 3B08TI010005-11S5; 2011
Category of Finding:	Cash Management
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

Criteria

TITLE 2 GRANTS AND AGREEMENTS, Subpart C – Post Award Requirements, Section 215.22 – Payment

(a) Payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients. Payment methods of State agencies or instrumentalities shall be consistent with Treasury-State CMIA agreements or default procedures codified at 31 CFR part 205.

Condition

ADP did not have adequate policies and procedures to ensure federal draw requests are reconciled to amounts recorded by the State Controller's Office (SCO). On July 1, 2013, ADP was combined into Health Care Services which took over management and operations of all ADP programs. Given the transition, Health Care Services was unable to reconcile the difference between the listing of federal draws provided by ADP to the amount drawn as reported by the SCO by approximately $3.1 million dollars. As a result, the Cash Management Improvement Act (CMIA) worksheets used by the Department of Finance to calculate interest owed may not have been accurate and complete.

Questioned Costs

No specific questioned costs were identified

Recommendations

Health Care Services should ensure it implements its own policies and procedures to ensure federal draw requests are reconciled to SCO records.

Department's View and Corrective Action Plan

DHCS agrees with the recommendation to implement its own policies and procedures to ensure Federal draw requests are reconciled to State Controller's Office (SCO) records. We began following the DHCS established policies and procedures for transactions beginning July 1, 2013.

Reconciling DHCS's listing of Federal draws for the Medicaid Cluster-Medical Assistance Program (Medi-Cal) to the SCO records has been a regular process performed at DHCS timely. The Block Grants for Prevention and Treatment of Substance Abuse will be incorporated into DHCS's reconciliation process. It should be noted that during the 2012 audit of the Medi-Cal Program that no questioned costs have been presented to DHCS regarding its process's over cash management.

Contact

John Cathey, Chief, Accounting

Implementation Date

July 1, 2013

Auditee's Section

Schedule Of Expenditures Of Federal Awards
Fiscal Year Ended June 30, 2013

STATE OF CALIFORNIA SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2013

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
U.S. Department of Agriculture				
Plant and Animal Disease, Pest Control, and Animal Care	10.025		$ 67,200,828	$ 24,667,790
Voluntary Public Access and Habitat Incentive Program	10.093		60,388	-
Market Protection and Promotion	10.163		3,216,528	-
Specialty Crop Block Grant Program – Farm Bill	10.170		19,228,487	16,500,714
Organic Certification Cost Share Programs	10.171		675,951	-
Farm Labor Housing Loans and Grants	10.405		2,277,602	-
Cooperative Agreements with States for Intrastate Meat and Poultry Inspection	10.475		254,265	-
Meat, Poultry, and Egg Products Inspection	10.477		121,556	56,961
Food Safety Cooperative Agreements	10.479		193,190	-
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557		1,108,075,568	257,352,849
Child and Adult Care Food Program	10.558		343,270,661	340,346,756
State Administrative Expenses for Child Nutrition	10.560		26,544,524	-
WIC Farmers' Market Nutrition Program (FMNP)	10.572		1,500,584	-
Team Nutrition Grants	10.574		95,614	-
Senior Farmers Market Nutrition Program	10.576		897,514	731,315
Child Nutrition Discretionary Grants Limited Availability	10.579		115,441	(95,220)
Fresh Fruit and Vegetable Program	10.582		8,727,514	8,727,514
Cooperative Forestry Assistance	10.664		5,084,878	1,434,200
Urban and Community Forestry Program	10.675		1,342,982	-
Forest Legacy Program	10.676		1,721,043	10,245
Forest Stewardship Program	10.678		658,095	137,107
Forest Health Protection	10.680		376,885	212,887
ARRA – Recovery Act of 2009: Wildland Fire Management, Recovery Act Funded	10.688		562,314	-
Soil and Water Conservation	10.902		58,208	-
Environmental Quality Incentives Program	10.912		(15,300)	-
Long-Term Standing Agreements For Storage, Transportation, and Lease	10.999		13,526,272	-
Total Excluding Clusters			1,605,771,592	650,083,118
SNAP Cluster				
Supplemental Nutrition Assistance Program, Recovery Act Funded	10.551		7,456,702,934	-
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		747,183,607	632,959,899
Total SNAP Cluster			8,203,886,541	632,959,899
Child Nutrition Cluster				
School Breakfast Program	10.553		410,993,151	410,993,151
National School Lunch Program	10.555		1,367,217,595	1,367,217,595
Special Milk Program for Children	10.556		375,831	375,831
Summer Food Service Program for Children	10.559		19,877,165	19,728,959
Total Child Nutrition Cluster			1,798,463,742	1,798,315,536

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Food Distribution Cluster				
Commodity Supplemental Food Program	10.565		$ 4,497,954	$ 4,493,406
Emergency Food Assistance Program (Administrative Costs)	10.568		9,122,648	8,646,142
Total Food Distribution Cluster			13,620,602	13,139,548
Forest Service Schools and Roads Cluster				
Schools and Roads – Grants to States	10.665		35,777,071	35,777,071
Total Forest Service Schools and Roads Cluster			35,777,071	35,777,071
Research and Development Cluster				
Plant and Animal Disease, Pest Control, and Animal Care	10.025		282,447	-
Research and Development Cluster			282,447	-
Total U.S. Department of Agriculture			11,657,801,995	3,130,275,172
Department of Commerce				
Interjurisdictional Fisheries Act of 1986	11.407		(3,970)	-
Coastal Zone Management Administration Awards	11.419		2,861,616	311,700
Coastal Zone Management Estuarine Research Reserves	11.420		786,850	570,857
Marine Sanctuary Program	11.429		25,903	25,903
Pacific Fisheries Data Program	11.437		-	-
Pass-Through from Pacific States Marine Fisheries		R1070002/ R1270003	1,245,310	-
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438		13,562,575	-
Regional Fishery Management Councils	11.441		-	-
Pass-Through from Pacific Fisheries Management Council		R1170002/ R1270004	142,469	116,746
Habitat Conservation	11.463		1,552,147	1,404,261
Meteorologic and Hydrologic Modernization Development	11.467		849,219	-
Applied Meteorological Research	11.468		77,724	77,718
Public Safety Interoperable Communications Grant Program	11.555		2,725,813	2,725,813
ARRA – State Broadband Data and Development Grant Program, Recovery Act Funded	11.558		1,614,936	-
Other – U.S. Department of Commerce	11.999		47,915	-
Total Excluding Cluster			25,488,507	5,232,998
Research and Development Cluster				
Unallied Management Projects	11.454		1,121,878	-
Unallied Science Program	11.472		18,565	-
Research and Development Cluster			1,140,443	-
Total Department of Commerce			26,628,950	5,232,998

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Department of Defense				
Planning Assistance to States	12.110		$ 1,624,981	-
Payments to States in Lieu of Real Estate Taxes	12.112		180,940	-
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		16,387,822	$3,621,402
Electronic Absentee Systems for Elections	12.217		308,820	-
National Guard Military Operations and Maintenance (O&M) Projects	12.401		74,156,128	-
National Guard Challenge Program	12.404		10,662,479	-
Community Economic Adjustment Assistance for Compatible Use and Joint Land Use Studies	12.610		24,350	-
Other – U.S. Department of Defense	12.999		1,457,344	-
Total Excluding Cluster			104,802,864	3,621,402
Research and Development Cluster				
Planning Assistance to States	12.110		1,685,449	-
Basic and Applied Scientific Research	12.300		9,351	-
Air Force Defense Research Sciences Program	12.800		32,117	-
Research and Development Cluster			1,726,917	-
Total Department of Defense			106,529,781	3,621,402
Department of Housing and Urban Development				
Manufactured Home Dispute Resolution	14.171		248,330	-
Emergency Solutions Grant Program	14.231		8,387,606	7,309,817
Home Investment Partnerships Program	14.239		83,144,342	78,690,822
Housing Opportunities for Persons with AIDS	14.241		3,631,812	-
ARRA – Homelessness Prevention and Rapid Re-Housing Program, Recovery Act Funded	14.257		2,772,632	2,777,572
Equal Opportunity in Housing	14.400		1,753,265	-
Lead-Based Paint Hazard Control in Privately-Owned Housing	14.900		475,505	336,614
Total Excluding Clusters			100,413,492	89,114,825
CDBG – State Administered CDBG Cluster				
Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii	14.228		57,746,393	54,571,898
ARRA – Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii, Recovery Act Funded	14.255		726,738	721,796
Total CDBG – State Administered CDBG Cluster			58,473,131	55,293,694
Housing Voucher Cluster				
Section 8 Housing Choice Vouchers	14.871		1,347,326	-
Total Housing Voucher Cluster			1,347,326	-
Total Department of Housing and Urban Development			160,233,949	144,408,519

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Department of the Interior				
National Fire Plan – Wildland Urban Interface Community Fire Assistance	15.228		$ (12,210)	-
Fish, Wildlife and Plant Conservation Resource Management	15.231		1,982,459	1,947,176
Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		157,543	-
ARRA – Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		99,655	-
Federal Oil and Gas Royalty Management State and Tribal Coordination	15.427		882,775	-
Minerals Leasing Act	15.437		85,174,351	-
Providing Water to At-Risk Natural Desert Terminal Lakes	15.508		49,307	-
Central Valley Project Improvement Act, Title XXXIV	15.512		2,141,129	-
Fish and Wildlife Coordination Act, Recovery Act Funded	15.517		145,616	-
ARRA – Fish and Wildlife Coordination Act, Recovery Act Funded	15.517		51,361	-
Total Fish and Wildlife Coordination Act			196,977	-
Recreation Resources Management	15.524		2,284,070	-
Central Valley Project, Trinity River Division, Trinity River Fish and Wildlife Management	15.532		38,643	-
California Water Security and Environmental Enhancement	15.533		85,590	-
Lake Tahoe Regional Wetlands Development Program	15.543		53,857	-
Fish and Wildlife Management Assistance	15.608		81,447	-
Coastal Wetlands Planning, Protection and Restoration Act	15.614		771,919	765,521
Cooperative Endangered Species Conservation Fund	15.615		23,051,676	-
Clean Vessel Act	15.616		1,707,200	-
Sportfishing and Boating Safety Act	15.622		468,000	-
Coastal Program	15.630		5,860	-
Landowner Incentive Program	15.633		107,086	-
State Wildlife Grants	15.634		109,178	-
Research Grants (Generic)	15.650		40,132	-
Endangered Species Conservation – Recovery Implementation Funds	15.657		8,185	-
Natural Resource Damage Assessment, Restoration and Implementation	15.658		505,911	-
Coastal Impact Assistance Program	15.668		1,937,580	1,937,580
National Wildlife Refuge Fund	15.669		2,619	-
Earthquake Hazards Reduction Program	15.807		46,812	-
U.S. Geological Survey – Research and Data Collection	15.808		134,708	-
National Cooperative Geologic Mapping Program	15.810		242,599	-
National Geological and Geophysical Data Preservation Program	15.814		2,261	-
Historic Preservation Fund Grants-In-Aid	15.904		1,205,559	-
Outdoor Recreation – Acquisition, Development and Planning	15.916		1,788,116	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
ARRA – Abandoned Mine Hazard Mitigation, Recovery Act Funded	15.934		$ 810,835	-
ARRA – Redwood National Park Cooperative Management with the State of California, Recovery Act Funded	15.937		3,078	-
Other – U.S. Department of the Interior	15.999		4,852,986	-
Total Excluding Clusters			131,017,893	4,650,277
Fish and Wildlife Cluster				
Sport Fish Restoration Program	15.605		2,137,005	-
Wildlife Restoration and Basic Hunter Education	15.611		1,949,868	-
Total Fish and Wildlife Cluster			4,086,873	-
Research and Development Cluster				
Challenge Cost Share	15.238		(3,655)	-
ARRA – Central Valley Project Improvement Act, Title XXXIV, Recovery Act Funded	15.512		2,141,129	-
San Luis Unit, Central Valley Project	15.527		38,624	-
California Water Security and Environmental Enhancement	15.533		115,493	-
Sport Fish Restoration Program	15.605		13,672,892	-
Fish and Wildlife Management Assistance	15.608		248,169	-
Wildlife Restoration and Basic Hunter Education	15.611		10,954,194	-
Cooperative Endangered Species Conservation Fund	15.615		4,185,388	-
State Wildlife Grants	15.634		3,089,937	-
Migratory Bird Conservation	15.647		132,398	-
Central Valley Project Improvement (CVPI) Anadromous Fish Restoration Program (AFRP)	15.648		279,730	-
Research Grants (Generic)	15.650		84,224	-
U.S. Geological Survey – Research and Data Collection	15.808		6,000	-
Technical Preservation Services	15.915		42,465	-
Research and Development Cluster			34,986,988	-
Total Department of the Interior			170,091,754	4,650,277
Department of Justice				
Law Enforcement Assistance – Narcotics and Dangerous Drugs – Laboratory Analysis	16.001		113,726	-
Sexual Assault Services Formula Program	16.017		619,529	604,888
Juvenile Accountability Block Grants	16.523		6,062,321	-
Juvenile Justice and Delinquency Prevention – Allocation to States	16.540		9,268,331	-
Title V – Delinquency Prevention Program	16.548		87,733	-
National Criminal History Improvement Program (NCHIP)	16.554		145,710	-
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560		172,239	-
Crime Victim Assistance	16.575		47,337,459	45,334,213

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Crime Victim Compensation	16.576		$ 30,938,708	-
Crime Victim Assistance/Discretionary Grants	16.582		13,764	-
Drug Court Discretionary Grant Program	16.585		67,034	-
Violence Against Women Formula Grants, Recovery Act Funded	16.588		10,993,545	10,093,431
Residential Substance Abuse Treatment for State Prisoners	16.593		1,811,493	1,690,301
State Criminal Alien Assistance Program	16.606		51,229,996	-
Bulletproof Vest Partnership Program	16.607		2,448,939	2,448,939
Project Safe Neighborhoods	16.609		$638,468	$573,966
Regional Information Sharing Systems	16.610			
Pass-Through from Western States Information Network, Inc.		WSIN MOU	1,973,738	-
ARRA – Public Safety Partnership and Community Policing Grants, Recovery Act Funded	16.710		286,684	-
Enforcing Underage Drinking Laws Program	16.727		230,502	-
Protecting Inmates and Safeguarding Communities Discretionary Grant Program	16.735		10,926	-
DNA Backlog Reduction Program	16.741		5,365,928	1,428,908
Paul Coverdell Forensic Sciences Improvement Grant Program	16.742		2,166,420	2,137,008
Convicted Offender and/or Arrestee DNA Backlog Reduction Program	16.748		102,898	-
Edward Byrne Memorial Competitive Grant Program	16.751		1,877	-
Congressionally Recommended Awards	16.753		2,101	-
Harold Rogers Prescription Drug Monitoring Program	16.754		29,005	-
ARRA – Recovery Act – State Victim Assistance Formula Grant Program, Recovery Act Funded	16.801		120,392	120,389
ARRA – Recovery Act – Edward Byrne Memorial Competitive Grant Program, Recovery Act Funded	16.808		(7,426)	-
ARRA – Recovery Act – Assistance to Rural Law Enforcement to Combat Crime and Drugs Competitive Grant Program, Recovery Act Funded	16.810		5,043	-
John R. Justice Prosecutors and Defenders Incentive Act	16.816		58,441	-
Total Excluding Clusters			172,295,524	64,432,043
JAG Program Cluster				
Edward Byrne Memorial Justice Assistance Grant Program	16.738		20,427,164	16,213,622
ARRA – Recovery Act – Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories, Recovery Act Funded	16.803		20,734,778	19,119,704
Total JAG Program Cluster			41,161,942	35,333,326
Total Department of Justice			213,457,466	99,765,369
Department of Labor				
Labor Force Statistics	17.002		6,701,238	-
Compensation and Working Conditions	17.005		603,594	-
Unemployment Insurance, Recovery Act Funded	17.225		12,751,743,576	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
ARRA – Unemployment Insurance, Recovery Act Funded	17.225		$ 20,506,807	-
Total Unemployment Insurance			12,772,250,383	-
Senior Community Service Employment Program	17.235		7,293,901	$6,890,388
Trade Adjustment Assistance	17.245		9,337,951	-
WIA Dislocated Workers, Recovery Act Funded	17.260		539,330	539,330
ARRA – WIA Dislocated Workers, Recovery Act Funded	17.260		2,133,336	2,133,336
Total WIA Dislocated Workers			2,672,666	2,672,666
Work Opportunity Tax Credit Program (WOTC)	17.271		2,651,935	-
Temporary Labor Certification for Foreign Workers	17.273		1,833,039	-
ARRA – Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors, Recovery Act Funded	17.275		1,943,582	1,954,712
Workforce Investment Act (WIA) National Emergency Grants	17.277		8,668,600	8,148,034
Occupational Safety and Health – State Program	17.503		27,778,008	-
ARRA – Occupational Safety and Health – State Program, Recovery Act Funded	17.503		75	-
Total Occupational Safety and Health			27,778,083	-
Consultation Agreements	17.504		5,369,341	-
Mine Health and Safety Grants	17.600		273,849	-
Total Excluding Clusters			12,847,378,162	19,665,800
Employment Service Cluster				
Employment Service/Wagner-Peyser Funded Activities	17.207		61,593,633	26,321,175
Disabled Veterans' Outreach Program (DVOP)	17.801		11,576,470	-
Local Veterans' Employment Representative Program	17.804		6,420,752	-
Total Employment Service Cluster			79,590,855	26,321,175
WIA Cluster				
WIA Adult Program	17.258		137,485,943	131,378,383
WIA Youth Activities	17.259		128,916,042	120,657,077
WIA Dislocated Worker Formula Grants	17.278		179,113,707	171,520,117
Total WIA Cluster			445,515,692	423,555,577
Total Department of Labor			13,372,484,709	469,542,552
Department of Transportation				
Airport Improvement Program	20.106		134,487	-
Highway Research and Development Program	20.200		486,357	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Highway Training and Education	20.215		$ 15,409	-
National Motor Carrier Safety	20.218		16,616,083	-
Performance and Registration Information Systems Management	20.231		196,485	-
Commercial Driver's License Program Improvement Grant	20.232		795,082	-
Fuel Tax Evasion – Intergovernmental Enforcement Effort	20.240		142,122	-
Capital Assistance to States – Intercity Passenger Rail Service	20.317		11,072,186	11,072,186
High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants, Recovery Act Funded	20.319		4,908,349	89,052
ARRA – High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants, Recovery Act Funded	20.319		109,836,303	3,868,746
Total High Speed Rail Corridors and Intercity Passenger Rail Service			114,744,652	3,957,798
Metropolitan Transportation Planning	20.505		69,823,885	68,585,233
Formula Grants for Rural Areas	20.509		21,939,971	20,575,141
ARRA – Formula Grants for Rural Areas, Recovery Act Funded	20.509		2,133,788	1,354,456
Total Formula Grants for Rural Areas			24,073,759	21,929,597
Public Transportation Research	20.514		34,020	-
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608		69,500,800	-
E-911 Grant Program	20.615		1,931,000	-
Pipeline Safety Program State Base Grant	20.700		3,534,045	-
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703		1,760,274	279,037
Total Excluding Clusters			314,860,646	105,823,851
Highway Planning and Construction Cluster				
Highway Planning and Construction	20.205		3,316,494,224	930,901,094
Pass-Through from Metropolitan Transportation Commission			282,887	-
ARRA – Highway Planning and Construction, Recovery Act Funded	20.205		202,592,277	34,737,839
Total Highway Planning and Construction Cluster			3,519,369,388	965,638,933
Federal Transit Cluster				
Federal Transit – Capital Investment Grants, Recovery Act Funded	20.500		521,509	145,028
Total Federal Transit Cluster			521,509	145,028
Transit Services Programs Cluster				
Enhanced Mobility of Seniors and Individuals with Disabilities	20.513		13,064,515	12,497,447
Job Access And Reverse Commute Program	20.516		2,069,679	1,953,627
New Freedom Program	20.521		1,943,204	1,880,855

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Total Transit Services Programs Cluster			$ 17,077,398	$ 16,331,929
Highway Safety Cluster				
State and Community Highway Safety	20.600		25,349,382	-
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601		3,887,924	-
Occupant Protection Incentive Grants	20.602		1,735,029	-
Safety Belt Performance Grants	20.609		265,730	-
State Traffic Safety Information System Improvement Grants	20.610		2,764,869	-
Incentive Grant Program to Increase Motorcyclist Safety	20.612		385,579	-
Child Safety and Child Booster Seats Incentive Grants	20.613		437,661	-
Total Highway Safety Cluster			34,826,174	-
Research and Development Cluster				
Highway Planning and Construction	20.205		15,778,000	-
Formula Grants for Rural Areas	20.509		190,575	-
State and Community Highway Safety	20.600		1,270	-
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601		181,784	-
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608		136,048	-
Research and Development Cluster			16,287,677	-
Total Department of Transportation			3,902,942,792	1,087,939,741
Department of Treasury				
National Foreclosure Mitigation Counseling	21.000		2,501,792	2,501,792
Equal Opportunity Employment Commission				
Employment Discrimination – Title VII of the Civil Rights Act of 1964	30.001		2,986,789	-
General Services Administration				
Election Reform Payments	39.011		1,353,310	-
National Endowment for the Arts				
Promotion of the Arts – Partnership Agreements	45.025		1,123,860	642,855
Grants to States	45.310		14,118,837	8,482,955
Total National Endowment for the Arts			15,242,697	9,125,810
Small Business Administration				
State Trade and Export Promotion Pilot Grant Program	59.061		1,254,374	873,637
Department of Veterans Affairs				

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Grants to States for Construction of State Home Facilities	64.005		$ 31,735,546	-
Burial Expenses Allowance for Veterans	64.101		342,472	-
All-Volunteer Force Educational Assistance	64.124		1,038,380	-
State Cemetery Grants	64.203		887,068	-
Total Department of Veterans Affairs			34,003,466	-
Environmental Protection Agency				
Air Pollution Control Program Support	66.001		5,891,895	$5,891,895
State Indoor Radon Grants	66.032		127,367	-
Surveys, Studies, Research, Investigations, Demonstrations, and Special Purpose Activities Relating to the Clean Air Act	66.034		457,177	-
National Clean Diesel Emissions Reduction Program, Recovery Act Funded	66.039		626,412	626,412
ARRA – National Clean Diesel Emissions Reduction Program, Recovery Act Funded	66.039		30,978	30,978
Total National Clean Diesel Emissions Reduction Program			657,390	657,390
State Clean Diesel Grant Program, Recovery Act Funded	66.040		317,185	317,185
The San Francisco Bay Water Quality Improvement Fund	66.126		67,519	43,869
Pass-Through from Association of Bay Area Governments			35,987	35,987
State Environmental Justice Cooperative Agreement Program	66.312		11,053	-
Water Pollution Control State, Interstate, and Tribal Program Support	66.419		7,814,494	-
Pass-Through from San Jose State University Foundation		R1175004	832,092	-
State Public Water System Supervision	66.432		8,595,269	-
State Underground Water Source Protection	66.433		499,516	-
Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements – Section 104(b)(3) of the Clean Water Act				-
Pass-Through from Association of Bay Area Governments	66.436		100,000	
Urban Waters Small Grants	66.440		7,029	-
Water Quality Management Planning, Recovery Act Funded	66.454		416,950	246,371
Nonpoint Source Implementation Grants	66.460		8,839,145	4,671,408
Regional Wetland Program Development Grants	66.461		27,382	17,994
Beach Monitoring and Notification Program Implementation Grants	66.472		628,004	106,810
Water Protection Grants to the States	66.474		22,610	-
Surveys, Studies, Investigations and Special Purpose Grants	66.606		453,663	453,663
Environmental Information Exchange Network Grant Program and Related Assistance	66.608		927,717	-
Consolidated Pesticide Enforcement Cooperative Agreements	66.700		1,461,910	-
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	66.707		490,425	-
Hazardous Waste Management State Program Support	66.801		7,585,437	-
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements, Recovery Act Funded	66.802		1,155,033	-

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Underground Storage Tank Prevention, Detection and Compliance Program	66.804		$ 606,840	$ 263,173
Leaking Underground Storage Tank Trust Fund Corrective Action Program, Recovery Act Funded	66.805		2,795,435	-
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809		86,716	-
Brownfields Training, Research, and Technical Assistance Grants and Cooperative Agreements	66.814		75,142	-
State and Tribal Response Program Grants	66.817		1,012,620	-
Brownfields Assessment and Cleanup Cooperative Agreements, Recovery Act Funded	66.818		867,699	867,699
Total Excluding Cluster			52,866,701	13,573,444
Research and Development Cluster				
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements, Recovery Act Funded	66.802		79,281	-
Research and Development Cluster			79,281	-
Total Environmental Protection Agency			52,945,982	13,573,444
Department of Energy				
State Energy Program	81.041		1,876,878	-
ARRA – State Energy Program, Recovery Act Funded	81.041		3,990,291	2,547,872
Total State Energy Program			5,867,169	2,547,872
Weatherization Assistance for Low-Income Persons	81.042		4,507,282	3,713,542
ARRA – Weatherization Assistance for Low-Income Persons, Recovery Act Funded	81.042		9,488,732	8,408,725
Total Weatherization Assistance for Low-Income Persons			13,996,014	12,122,267
Nuclear Waste Disposal Siting	81.065		325,229	-
ARRA – Conservation Research and Development, Recovery Act Funded	81.086		271,129	-
Renewable Energy Research and Development	81.087		276,343	-
Fossil Energy Research and Development	81.089		765,379	765,379
Environmental Remediation and Waste Processing and Disposal	81.104		285,740	-
State Energy Program Special Projects	81.119		162,274	161,494
ARRA – Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded	81.122		1,525,680	32,576
Pass-Through from Sacramento Municipal Utility District (SMUD)	81.122		2,315,931	-
Total ARRA – Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded			3,841,611	32,576
ARRA – Energy Efficient Appliance Rebate Program (EEARP), Recovery Act Funded	81.127		(4,750)	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG), Recovery Act Funded	81.128		$ 22,129,175	$ 21,557,719
Long-Term Surveillance and Maintenance	81.136		13,639	-
Total Department of Energy			47,928,952	37,187,307
Department of Education				
Adult Education – Basic Grants to States	84.002		76,964,621	74,005,376
Migrant Education – State Grant Program	84.011		138,118,872	117,151,790
Title I State Agency Program for Neglected and Delinquent Children and Youth	84.013		1,599,094	1,584,686
Career and Technical Education – Basic Grants to States	84.048		118,955,876	109,284,587
Rehabilitation Services – Vocational Rehabilitation Grants to States	84.126		273,978,131	-
Rehabilitation Services – Client Assistance Program	84.161		1,328,330	-
Independent Living – State Grants	84.169		2,783,021	2,801,555
Rehabilitation Services – Independent Living Services for Older Individuals Who are Blind	84.177		3,322,003	3,145,081
Safe and Drug-Free Schools and Communities – National Programs	84.184		4,218,037	1,503,031
Safe and Drug-Free Schools and Communities – State Grants	84.186		(425)	-
Supported Employment Services for Individuals with the Most Significant Disabilities	84.187		3,015,117	-
Education for Homeless Children and Youth	84.196		9,349,870	8,963,212
Even Start – State Educational Agencies	84.213		189,668	155,200
Assistive Technology	84.224		958,058	-
Tech-Prep Education	84.243		12	12
Rehabilitation Training – State Vocational Rehabilitation Unit In-Service Training	84.265		355,928	-
Charter Schools	84.282		28,039,206	26,513,521
Twenty-First Century Community Learning Centers	84.287		127,091,010	124,277,848
Special Education – State Personnel Development	84.323		2,392,017	2,388,140
Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	84.330		10,083,732	10,083,732
Grants to States for Workplace and Community Transition Training for Incarcerated Individuals	84.331		88,018	-
Credit Enhancement for Charter School Facilities	84.354		8,300,000	-
Rural Education	84.358		1,385,688	1,381,533
English Language Acquisition State Grants	84.365		177,971,626	173,002,072
Mathematics and Science Partnerships	84.366		24,520,628	23,680,357
Improving Teacher Quality State Grants	84.367		298,881,342	287,988,684
Grants for State Assessments and Related Activities	84.369		29,937,448	21,842,486
Striving Readers	84.371		293,258	-
College Access Challenge Grant Program	84.378		13,599,985	5,571,559
Education Jobs Fund	84.410		49,744,082	49,438,382
Race to the Top – Early Learning Challenge	84.412		12,404,298	10,648,020
Total Excluding Clusters			1,419,868,551	1,055,410,864

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Title I, Part A Cluster				
Title I Grants to Local Educational Agencies	84.010		$ 1,680,801,666	$ 1,668,589,297
ARRA – Title I Grants to Local Educational Agencies, Recovery Act Funded	84.389		141,051	141,051
Total Title I, Part A Cluster			1,680,942,717	1,668,730,348
Special Education Cluster (IDEA)				
Special Education – Grants to States	84.027		954,789,189	923,876,762
Special Education – Preschool Grants	84.173		$31,866,464	$30,912,428
Total Special Education Cluster (IDEA)			986,655,653	954,789,190
Early Intervention Services (IDEA) Cluster				
Special Education-Grants for Infants and Families	84.181		19,742,839	19,742,839
Total Early Intervention Services (IDEA) Cluster			19,742,839	19,742,839
Educational Technology State Grants Cluster				
Educational Technology State Grants	84.318		5,308,147	5,101,130
ARRA – Education Technology State Grants, Recovery Act Funded	84.386		365,544	345,363
Total Educational Technology State Grants Cluster			5,673,691	5,446,493
School Improvement Grants Cluster				
School Improvement Grants	84.377		59,022,747	58,502,513
ARRA – School Improvement Grants, Recovery Act Funded	84.388		104,989,782	104,989,782
Total School Improvement Grants Cluster			164,012,529	163,492,295
State Fiscal Stabilization Fund Cluster				
ARRA – State Fiscal Stabilization Fund (SFSF) – Education State Grants (Education Stabilization Fund), Recovery Act Funded	84.394		21,468	-
Total State Fiscal Stabilization Fund Cluster			21,468	-
Total Department of Education			4,276,917,448	3,867,612,029
U.S. Election Assistance Commission				
Help America Vote Act Requirements Payments	90.401		6,036,832	-
U.S. Election Assistance Commission Research Grants	90.403		77	-
Total U.S. Election Assistance Commission			6,036,909	-
Department of Health and Human Services				
State and Territorial and Technical Assistance Capacity Development Minority HIV/AIDS Demonstration Program	93.006		8,819	-
Strengthening Public Health Services at the Outreach Offices of the U.S.-Mexico Border Health Commission	93.018		285,192	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Special Programs for the Aging – Title VII, Chapter 3 – Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041		$ 473,741	$ 470,044
Special Programs for the Aging – Title VII, Chapter 2 – Long-Term Care Ombudsman Services for Older Individuals	93.042		1,646,410	1,546,611
Special Programs for the Aging – Title III, Part D – Disease Prevention and Health Promotion Services	93.043		2,099,031	2,099,031
Special Programs for the Aging – Title IV – and Title II – Discretionary Projects, Recovery Act Funded	93.048		221,117	-
ARRA -Special Programs for the Aging – Title IV – and Title II – Discretionary Projects, Recovery Act Funded	93.048		208,292	-
Total Special Programs for the Aging – Title IV – and Title II – Discretionary Projects			429,409	-
Alzheimer's Disease Demonstration Grants to States	93.051		306,215	306,215
National Family Caregiver Support, Title III, Part E	93.052		15,676,155	15,073,327
Public Health Emergency Preparedness	93.069		10,615,119	29,880,188
Environmental Public Health and Emergency Response	93.070		75,997	-
Hospital Preparedness Program (HPP) and Public Health Emergency Preparedness (PHEP) Aligned Cooperative Agreements	93.074		41,059,491	-
Systems Interoperabiltiy – Health and Human Services	93.075		439,857	-
Emergency System for Advance Registration of Volunteer Health Professionals	93.089		70,596	-
ARRA – Guardianship Assistance, Recovery Act Funded	93.090		37,046,748	36,991,329
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		5,605,556	4,433,867
Food and Drug Administration – Research	93.103		1,094,620	-
Maternal and Child Health Federal Consolidated Programs	93.110		149,194	127,820
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		7,082,460	3,831,176
Emergency Medical Services for Children	93.127		218,849	-
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	93.130		285,040	-
Centers for Research and Demonstration for Health Promotion and Disease Prevention	93.135		780,169	-
Injury Prevention and Control Research and State and Community Based Programs	93.136		2,886,518	-
Projects for Assistance in Transition from Homelessness (PATH)	93.150		10,970,996	-
Health Program for Toxic Substances and Disease Registry	93.161		593,421	-
Grants to States for Loan Repayment Program	93.165		753,694	753,694
Disabilities Prevention	93.184		(4,630)	-
Grants to States to Support Oral Health Workforce Activities	93.236		857,228	-
State Rural Hospital Flexibility Program	93.241		$500,447	-
Substance Abuse and Mental Health Services – Projects of Regional and National Significance	93.243		4,024,216	850,000
Universal Newborn Hearing Screening	93.251		405,255	100,000
Adult Viral Hepatitis Prevention and Control	93.270		18,459	-
Substance Abuse and Mental Health Services – Access to Recovery	93.275		3,597,453	-
Centers for Disease Control and Prevention – Investigations and Technical Assistance	93.283		17,767,680	4,165,059
Small Rural Hospital Improvement Grant Program	93.301		$406,590	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
ARRA – State Loan Repayment Program, Recovery Act Funded	93.402		$ 1,311,294	$ 1,311,294
ARRA – Equipment to Enhance Training for Health Professionals, Recovery Act Funded	93.411		15,552	-
ARRA – State Primary Care Offices, Recovery Act Funded	93.414		359,186	207,177
Food Safety and Security Monitoring Project	93.448		631,123	-
ARRA – Pregnancy Assistance Fund Program, Recovery Act Funded	93.500		2,451,338	$1,512,906
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505		23,251,220	10,775,720
ACA Nationwide Program for National and State Background Checks for Direct Patient Access Employees of Long Term Care Facilities and Providers	93.506		636,697	499,240
PPHF 2012 National Public Health Improvement Initiative	93.507		864,891	-
Affordable Care Act (ACA) State Health Care Workforce Development Grants	93.509		28,052	-
Affordable Care Act (ACA) Grants to States for Health Insurance Premium Review	93.511		1,102,736	-
Affordable Care Act (ACA) Personal and Home Care Aide State Training Program (PHCAST)	93.512		830,933	751,612
Affordable Care Act – Aging and Disability Resource Center	93.517		224,782	-
Affordable Care Act – Medicare Improvements for Patients and Providers	93.518		187,058	187,058
Affordable Care Act (ACA) – Consumer Assistance Program Grants	93.519		3,408,559	-
Centers for Disease Control and Prevention – Affordable Care Act (ACA) – Communities Putting Prevention to Work	93.520		338,325	-
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		212,188	-
The Affordable Care Act: Human Immunodeficiency Virus (HIV) Prevention and Public Health Fund Activities	93.523		(529)	-
Pass-Through from Public Health Institute	93.536	1017721	1,555,254	-
PPHF 2012 – Prevention and Public Health Fund (Affordable Care Act) – Capacity Building Assistance to Strengthen Public Health Immunization Infrastructure and Performance financed in part by 2012 Prevention and Public Health Funds	93.539		496,167	594,000
The Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) authorizes Coordinated Chronic Disease prevention and Health Promotion Program	93.544		1,044,864	-
PPHF2013: State Nutrition, Physical Activity, and Obesity Programs – financed in part by 2013 PPHF	93.548		401,426	-
Promoting Safe and Stable Families	93.556		34,644,530	33,102,342
Child Support Enforcement	93.563		620,114,284	491,251,702
Child Support Enforcement Research	93.564		11,885	-
Refugee and Entrant Assistance – State Administered Programs	93.566		28,655,264	15,077,102
Low-Income Home Energy Assistance	93.568		197,264,858	187,834,206
Refugee and Entrant Assistance – Discretionary Grants	93.576		1,360,305	1,169,445
U.S. Repatriation	93.579		10,030	-
Refugee and Entrant Assistance – Targeted Assistance Grants	93.584		6,452,330	6,288,602
State Court Improvement Program	93.586		2,369,160	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Community-Based Child Abuse Prevention Grants	93.590		$ 4,833,080	$ 4,540,896
Grants to States for Access and Visitation Programs	93.597		979,933	-
Chafee Education and Training Vouchers Program (ETV)	93.599		5,930,769	5,892,633
Adoption Incentive Payments	93.603		(35,796)	(35,796)
Voting Access for Individuals with Disabilities – Grants to States	93.617		1,287,247	-
Developmental Disabilities Basic Support and Advocacy Grants	93.630		6,677,208	-
Children's Justice Grants to States	93.643		1,868,652	1,724,116
Stephanie Tubbs Jones Child Welfare Services Program	93.645		31,683,608	31,683,608
Child Welfare Research Training or Demonstration	93.648		3,579,966	3,567,215
Foster Care – Title IV-E, Recovery Act Funded	93.658		1,179,432,670	1,117,982,105
ARRA – Foster Care – Title IV-E	93.658		39,200	39,200
Total Foster Care – Title IV-E			1,179,471,870	1,118,021,305
Adoption Assistance, Recovery Act Funded	93.659		432,947,290	416,878,606
ARRA – Adoption Assistance	93.659		(10,570)	(10,570)
Total Adoption Assistance			432,936,720	416,868,036
Social Services Block Grant	93.667		576,975,899	305,238,945
Child Abuse and Neglect State Grants	93.669		3,423,537	3,163,502
Family Violence Prevention and Services/Grants for Battered Women's Shelters – Grants to States and Indian Tribes	93.671		7,944,879	7,928,638
Chafee Foster Care Independence Program	93.674		16,372,833	15,357,039
ARRA – Prevention and Wellness – State, Territories and Pacific Islands	93.723		485,801	-
ARRA – Prevention and Wellness – Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)	93.724		385,254	410,251
Capacity Building Assistance to Strengthen Public Health Immunization Infrastructure and Performance – financed in part by the Prevention and Public Health Fund (PPHF-2012)	93.733		-	234,000
Empowering Older Adults and Adults with Disabilities through Chronic Disease Self-Management Education Programs – financed by 2012 Prevention and Public Health Funds (PPHF-2012)	93.734		16,980	-
State Public Health Approaches for Ensuring Quitline Capacity – Funded in part by 2012 Prevention and Public Health Funds (PPHF-2012)	93.735		82,623	-
PPHF-2012: Breast Cancer and Screening Opportunities for States, Tribes and Territories solely financed by 2012 Prevention and Public Health Funds	93.744		404,106	-
PPHF-2012: Health Care Surveillance/Health Statistics – Surveillance Program Announcement: Behavioral Risk Factor Surveillance System Financed in Part by 2012 Prevention and Public Health Funds (PPHF-2012)	93.745		89,378	99,888
Children's Health Insurance Program	93.767		1,135,411,384	-
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		5,007,893	4,412,031
Money Follows the Person Rebalancing Demonstration	93.791		35,668,594	-

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Specially Selected Health Projects	93.888		$ (21,358)	-
National Bioterrorism Hospital Preparedness Program	93.889		18,642,031	23,732,450
Pass-Through from Emergency Preparedness Office			620,080	-
Grants to States for Operation of Offices of Rural Health	93.913		146,201	-
HIV Care Formula Grants	93.917		165,651,369	29,449,403
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938		662,410	-
HIV Prevention Activities – Health Department Based	93.940		18,325,847	-
ARRA - Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	93.943		4,239,542	-
Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944		4,475,464	-
Tuberculosis Demonstration, Research, Public and Professional Education	93.947		(435,241)	-
Block Grants for Community Mental Health Services	93.958		67,611,664	67,083,991
Block Grants for Prevention and Treatment of Substance Abuse	93.959		89,537,519	-
Preventive Health Services – Sexually Transmitted Diseases Control Grants	93.977		5,484,887	-
Preventive Health and Health Services Block Grant	93.991		3,735,721	-
Maternal and Child Health Services Block Grant to the States	93.994		30,349,426	19,908,574
Other-Department of Health and Human Services	93.999		22,092,103	-
ARRA – Other – Department of Health and Human Services, Recovery Act Funded	93.999		179,454	179,454
Total Other – Department of Health and Human Services			22,271,557	179,454
Total Excluding Clusters			4,981,239,294	2,722,816,740
Aging Cluster				
Special Programs for the Aging – Title III, Part B – Grants for Supportive Services and Senior Centers	93.044		39,079,290	36,655,585
Special Programs for the Aging – Title III, Part C – Nutrition Services	93.045		60,949,733	58,907,576
Nutrition Services Incentive Program	93.053		13,142,370	13,142,370
ARRA – Aging Congregate Nutrition Services for States, Recovery Act Funded	93.707		1	1
Total Aging Cluster			113,171,394	108,705,532
Immunization Cluster				
Immunization Cooperative Agreements	93.268		28,212,194*	-
Total Immunization Cluster			28,212,194	-
TANF Cluster				
Temporary Assistance for Needy Families	93.558		3,128,279,833	2,242,964,028

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
ARRA – Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program, Recovery Act Funded	93.714		$ 34,354,404	$ 34,354,404
Total TANF Cluster			3,162,634,237	2,277,318,432
CSBG Cluster				
Community Services Block Grant	93.569		55,417,789	52,908,554
Total CSBG Cluster			55,417,789	52,908,554
CCDF Cluster				
Child Care and Development Block Grant	93.575		232,868,772	220,710,075
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		302,025,056	275,702,350
Total CCDF Cluster			534,893,828	496,412,425
Head Start Cluster				
Head Start	93.600		157,475	-
ARRA – Head Start, Recovery Act Funded	93.708		4,664,588	4,471,337
Total Head Start Cluster			4,822,063	4,471,337
Medicaid Cluster				
Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative, Recovery Act Funded	93.720		(2,409)	-
State Medicaid Fraud Control Units	93.775		20,299,780	-
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	93.777		47,123,922	-
Medical Assistance Program	93.778		31,508,293,790	6,253,354,889
Total Medicaid Cluster			31,575,715,083	6,253,354,889
Research and Development Cluster				
Tuberculosis Demonstration, Research, Public and Professional Education	93.947		436,605	-
Research and Development Cluster			436,605	-
Total Department of Health and Human Services			40,456,542,487	11,915,987,909
Corporation for National and Community Service				
State Commissions	94.003		884,780	-
Learn and Serve America – School and Community Based Programs	94.004		61,905	55,000
AmeriCorps, Recovery Act Funded	94.006		22,815,385	22,815,385
Volunteer Generation Fund	94.021		247,843	-
Total Excluding Clusters			24,009,913	22,870,385

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Foster Grandparent/Senior Companion Cluster				
Foster Grandparent Program	94.011		$ 1,065,481	$ 467,988
Total Foster Grandparent/Senior Companion Cluster			1,065,481	467,988
Total Corporation for National and Community Service			25,075,394	23,338,373
Executive Office of the President				
High Intensity Drug Trafficking Areas Program	95.001			
Pass-Through from INCH/LA Police Chief's Association/Riverside County		G11LA0007A	39,716	-
Pass-Through from INCH/LA Police Chief's Association/Riverside County		G12LA0007A	32,448	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G10LA0006A	6,534	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G11LA0006A	76,862	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G12LA0006A	942,408	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G10LA0006A	2,921	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G11LA0006A	72,268	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G12LA0006A	105,587	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G11LA0006A	82,492	-
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G12LA0006A	203,093	-
Pass-Through from NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD		G11NV0001A	13,723	-
Pass-Through from NV HIDTA/LA Police Chief's Association/Las Vegas Metro PD		G11NV0001A	13,744	-
Pass-Through from CV HIDTA/LA Police Chief's Association/ Sacramento County		G10CV0002A	4,291	-
Pass-Through from CV HIDTA/LA Police Chief's Association/ Sacramento County		G11CV0002A	39,944	-
Pass-Through from CV HIDTA/LA Police Chief's Association/ Sacramento County		G12CV0002A	9,792	-
Pass-Through from CA Border Alliance Group/City of San Diego/ San Diego Police Dept (BI)		G12SC0001A	598,562	-
Total Executive Office of the President			2,244,385	-
Social Security Administration				
Disability Insurance/SSI Cluster				
Social Security – Disability Insurance	96.001		204,042,650	
Total Social Security Administration			204,042,650	-
Department of Homeland Security				
Non-Profit Security Program	97.008		2,023,103	1,935,450
Boating Safety Financial Assistance	97.012		4,357,092	-
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023		267,848	-
Flood Mitigation Assistance	97.029		1,454,297	1,371,664

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036		$ 101,225,269	$ 98,462,965
Hazard Mitigation Grant	97.039		12,117,853	10,865,548
National Dam Safety Program	97.041		134,821	-
Emergency Management Performance Grants	97.042		22,225,139	13,119,435
Assistance to Firefighters Grant	97.044		$15,448	-
Cooperating Technical Partners	97.045		1,065,597	-
Fire Management Assistance Grant	97.046		27,290,405	26,134,903
Pre-Disaster Mitigation	97.047		1,698,784	1,202,685
Emergency Operations Center	97.052		3,390,176	3,390,176
Interoperable Emergency Communications	97.055		3,298,506	2,812,159
Homeland Security Grant Program	97.067		298,021,227	277,880,438
Pass-Through from San Diego Sheriff's Department		Unknown	503,220	-
Pass-Through from Imperial County		Unknown	160,745	-
Pass-Through from CalEMA		000-92091	321,443	-
Pass-Through from Sacramento County Sheriff's Department		R0995006 #3	10,175	24,906
Pass-Through from Imperial County		R1095002/ R1095012/ R1195012	123,670	77,302
Pass-Through from San Diego County Sheriff's Department		R1095007 #2	116,385	95,423
Total Homeland Security Grant Program			299,256,865	278,078,069
Rail and Transit Security Grant Program	97.075		13,265,949	12,874,153
Buffer Zone Protection Program (BZPP)	97.078		9,084,670	8,936,093
Earthquake Consortium	97.082		318,435	120,364
Driver's License Security Grant Program	97.089		2,101,881	
Severe Repetitive Loss Program	97.110		1,132,575	1,038,925
Regional Catastrophic Preparedness Grant Program (RCPGP)	97.111		6,524,207	6,524,207
Border Interoperability Demonstration Project	97.120		684,237	669,854
Radiological/Nuclear Detection Pilot Evaluations Program	97.121		261,825	261,825
Total Department of Homeland Security			513,194,982	467,798,475
Miscellaneous Grants and Contracts				
Miscellaneous Expenditures of Federal Awards	99.099		50,516	-
Miscellaneous Federal Receipts	99.999		4,153,150	-
Pass-through from Miscellaneous Entities	Unknown		115,859	-
Total Miscellaneous Grants and Contracts			4,319,525	-
Total Expenditures of Federal Awards			**$75,256,762,538**	**$21,283,434,806**

* 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, 2013. 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, 2013

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, 2013, except for federal awards received by the University of California system, a component unit of the State of California, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health's Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, a component unit of the State of California which received $4.1 billion, $2.5 billion, $181.4 million, $116.4 million, and $64.1 million, respectively. 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 for federal funds. All expenditures for each program are net of applicable program income and refunds. Expenditures included in the Schedule are presented on a cash basis.

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 (CFDA No. 17.225). EDD lacks programming to differentiate all federal funds received and expended for unemployment benefit payments under the American and Reinvestment Recovery Act (Recovery Act), but believes only a small portion of the benefit payments in fiscal year 2012-13 were Recovery Act funded. The Recovery Act amount of $20,506,807 shown on the Schedule is for administrative expenditures.

4. RECOVERY ACT FUNDING OF SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM BENEFITS

The reported expenditures 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 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 7.79 percent of USDA's total expenditures for SNAP benefits in the Federal fiscal year ended September 30, 2013.

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 fiscal year ended June 30, 2013 are as follows:

FEDERAL CATALOG NUMBER	PROGRAM	NONCASH AWARDS FOR THE YEAR ENDED JUNE 30, 2013
10.565	Commodity Supplemental Food Program	$21,297,180
10.569	Emergency Food Assistance Program (Food Commodities)	87,795,499
10.555	National School Lunch Program	143,167,136
39.003	Donation of Federal Surplus Personal Property	59,870,307
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	445,545
93.268	Immunization Cooperative Agreements	403,648,421
94.031	Volunteers in Service to America	167,046
None *	Upper Truckee River Sunset Stables Reach 5	249,751
	Total	**$ 716,640,885**

* 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, 2013 are summarized below:

FEDERAL CATALOG NUMBER	PROGRAM	LOANS/LOAN GUARANTEES OUTSTANDING AT JUNE 30, 2013	INSURANCE IN EFFECT AT JUNE 30,2013
14.228	Community Development Block Grants- State's Program and Non-Entitlement Grants in Hawaii	$34,269,337	$
14.235	Supportive Housing Program	773,257	
81.041	State Energy Program	1,863,319	
21.999	State Small Business Credit Initiative Program	84,036,716	3,454,645
64.114	Veterans Housing- Guaranteed and Insured Loans		71,434,648
	Total	**$ 120,942,629**	**$ 74,889,293**

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.

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: 2012-12-2

Federal Program: 10.551

State Administering Department: Department of Social Services (Social Services)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. Social Services did not formally communicate with the state automated welfare systems consortia and county welfare departments the specific federal laws and regulations related to their responsibility to monitor their Supplemental Nutrition Assistance Program (SNAP) eligibility determination systems and for Electronic Benefit Transfers card security.

Status of Corrective Action: Partially Corrected. On June 28, 2013, an All-County Welfare Directors Letter was issued to the Statewide Automated Welfare Systems (SAWS) consortia and county welfare departments (CWDs) which specified the specific federal laws and regulations related to their responsibility to monitor their SNAP eligibility determination systems and for Electronic Benefit Transfer (EBT) card security.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-002.

Reference Number: 2012-12-3

Federal Program: 10.557

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Eligibility. Public Health did not properly design or implement certain information security and change management controls over the Integrated Statewide Information Systems (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.

Status of Corrective Action: Partially Corrected. Public Health has implemented a certification process to document the review and approval of ISIS change order requests for production implementation. The certificate is signed by Information Technology Services Division (ITSD) managers and/or Women, Infants, and Children (WIC) Program managers. The certificate is stored/kept by the ITSD Change Control Coordinator.

ITSD has also entered into queue, a work order change request item to encrypt ISIS passwords at the database level. The planned date of change is December 2013

Public Health utilizes the ISIS State Admin Log form to formally document the separation of WIC employees and to "Delete ISIS Logon ID". The form is signed/approved by WIC Program managers with a copy sent to the Program Business Integrity Section for retention.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-006.

Reference Number: 2012-12-4

Federal Program: 10.557

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting. 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. When a contract amendment increased the amount of a 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.

Status of Corrective Action: Fully Corrected. In December 2012, Women, Infants and Children's (WIC) Financial Management and Reporting Branch (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 worked with Public Health Accounting to establish more internal controls.

On February 6, 2013, the U.S. Department of Agriculture provided new FFATA reporting requirements. WIC has updated its desk procedures with the new FFATA requirements.

Reference Number: 2012-12-5

Federal Program: 93.658
93.659
93.667
93.720
93.775
93.777
93.778

State Administering Department: Department of Social Services (Social Services)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. Social Services does not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements. Social Services also does not have a documented risk-based audit plan, including an approach to selecting counties for site visits. 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. Failure to properly monitor subrecipients increases the risk that federal monies will be paid for unallowable costs.

Status of Corrective Action:

Fully Corrected. Social Services agrees with the recommendations and has established a risk-based monitoring plan using specified criteria. Social Services also notes 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 fiscal year 2011-12 on-site monitoring reviews.

Social Services received approval of its Corrective Action Implementation Plan (CAIP) related to multiple audit findings issued in 2010. In accordance with the CAIP, Social Services completed five county on-site monitoring reviews in 2010-11 through a one-time redirection of staff. In a September 23, 2011 letter from ACF, Social Services was commended for "well-planned and executed on-site monitoring reviews," but was also notified that Social Services must complete additional on-site monitoring reviews in 2011-12 to avoid additional audit findings and enforcement actions. The California State Auditor's Office 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, Social Services informed ACF that it intended to perform on-site monitoring reviews in 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 2011-12 which at that time was a total of three reviews. All scheduled on-site monitoring reviews were completed in 2011-12.

Per discussions with FNS, every county should have a review regardless of size. 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 fiscal year. ACF acknowledged on-site monitoring reviews must continue at a minimum of one county per quarter. Additionally, ACF acknowledged improvement in Social Services' monitoring process and has stated its appreciation of its continuing work to improve the process and meet federal expectations. ACF will also continue to monitor Social Services' on-site monitoring reviews.

Of the three counties monitored in 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 Budget 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 original CAIP criteria was related to American Recovery and Reinvestment Act (ARRA) funding; however, it 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 2011-12 based on requests from those counties. These counties had expressed concerns regarding their interpretation of allowable costs and requested Social Services' assistance in validating their claims. Social Services 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 Social Services' oversight.

To correct this finding, Social Services will add an additional criterion for review beginning with reviews conducted in 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.

Social Services 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.

Reference Number:	2012-12-6
Federal Program:	10.551 10.561 20.205 (ARRA) 20.219 93.558 93.714 (ARRA) 93.772 93.775 93.777 93.778
State Administering Department:	State Controller's Office (SCO)
Fiscal Year Initially Reported:	2011-12
Audit Finding:	Subrecipient Monitoring. SCO does not have adequate procedures to ensure findings are identified in OMB-A133 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. In 67 audits tested that were reviewed by SCO, it was found that 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. SCO has indicated that it was not fully responsible for identifying findings related to federal funds and that State departments are ultimately responsible for review of OMB A-133 reports. However, discussions with various State departments revealed that they rely on the initial review by the SCO and ultimately only follow up on findings reported to them by the SCO.

Status of Corrective Action: Fully Corrected. SCO revised its preliminary review procedures in November 2012 to require that all audit reports are secondarily reviewed by a lead auditor to ensure all audit findings are identified, and the appropriate state department is notified. SCO has corrected all of the issues identified in the finding.

Reference Number: 2012-12-7

Federal Program: 14.239

State Administering Department: Department of Housing and Community Development (Housing)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. Housing does not have a process in place to obtain Data Universal Numbering System (DUNS) numbers from its HOME Investment Partnerships Program (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. By not obtaining a DUNS number prior to awarding HOME Program funds, Housing puts at risk its federal funding.

Status of Corrective Action: Fully Corrected. DUNS numbers have been obtained on all active contracts (funded after 10/10/2010 and later). DUNS numbers were required in all HOME applications submitted in 2013. DUNS numbers will be required from all applicants for HOME funding going forward.

Auditors' Comment: We reported a similar finding in the 2013 audit due to the fact that EDD was not in compliance during the full year. Please refer to finding 2013-012.

Reference Number: 2012-12-8

Federal Program: 17.225

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Special Tests and Provisions. EDD's formal information security and user awareness policies and procedures were not in place for the entire fiscal year. EDD did not have a policy to formally document timely deactivation of employee's access to the Accounting and Compliance Enterprise System (ACES). Additionally, the information technology (IT) general controls over emergency and system changes to ACES were not operating effectively. EDD also 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.

Status of Corrective Action:

Fully Corrected. The review of user access will continue to be made regularly on an annual basis. The following are the corrective actions taken by the Employment Development Department (EDD):

1. Remove access upon termination and maintain evidence to reflect timely deactivation, and review access on a periodic basis.

To help keep the Automated Collection Enhancement System (ACES) user profiles current, in the fall of 2012 EDD implemented a quarterly email reminder to all Tax Branch managers and supervisors and non-Tax and external agency single points of contact to remind them to notify ACES security of all transfers, terminations, and separations.

The EDD has cleared ACES of inactive users. In September 2012, EDD inactivated all users who had not accessed ACES within 120 days. In January 2013, EDD performed manual adjustments to inactivate all users who had not accessed ACES within 90 days.

On March 14, 2013, an automated nightly job was implemented that inactivates all users who have not accessed ACES within 90 days. In February 2013, EDD updated the ACES Access procedures on the Information Technology Branch's self-service portal to include instructions for access deletions. In addition, EDD's Appointment/Separation Checklist was modified to include removal of access to ACES upon termination from EDD. The updated checklist has been sent to EDD's Information Security Office for approval.

2. Enforce segregation of duties so that employees cannot make and approve changes to ACES.

On September 15, 2012, EDD implemented the ACES Developer Segregation of Duties Standards that enforces segregation of duties such that an employee cannot make and approve changes in ACES. The standard states that a developer cannot be the approver of changes that they make and must have the team lead developer over their area approve the changes. The team lead developer will then schedule the migration.

The same standard applies to the team lead developer. If a team lead developer is making changes, he/she will have to obtain approval of the changes from their peer team lead before the code is presented to the ACES change control board and ultimately migrated into production.

3. Ensure program changes are approved by authorized individuals prior to implementation.

In September 2011, the ACES Standards Change Control Process was implemented to ensure that authorized individuals approve all program changes.

For a standard change, a developer will have to get the Business Analyst to approve the code via a user acceptance test. The next level of approval is the team lead developer. Once the team lead developer approves the change, the requested change is then reviewed during the weekly Change Control Board meeting where it receives the final approval.

For urgent changes, the developer will have to get the Business Analyst to approve the code via a user acceptance test. The next level of approval is both the business and Information Technology Branch management teams. Finally, it is approved by the vendor lead developer for migration into production.

Auditors' Comment: While EDD implemented certain recommendations from the prior year, we reported a similar finding in the 2013 audit. Please refer to finding 2013-019.

Reference Number: 2012-12-9

Federal Program: 17.225

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Special Tests and Provisions – UI Benefit Payments. An EDD Benefit Accuracy Measurement (BAM) analyst misclassified the results of a file review and the peer review by another BAM analyst did not detect the error. 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. EDD should reinforce its policies and procedures, and provide additional training to ensure BAM analysts properly classify results and peer reviewers perform thorough reviews over case files.

Status of Corrective Action: Fully Corrected. On February 25, 2013, EDD's Unemployment Insurance Program Analysis and Evaluation Section Chief sent an email to BAM staff reinforcing the need to properly classify results to ensure that the coding reflects the evidence collected and that a thorough peer review should be conducted.

Reference Number: 2012-12-10

Federal Program: 17.225

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2008-2009

Audit Finding: Special Tests and Provisions – Awards with ARRA Funding. EDD has not updated its financial management systems to allow it to separately identify and report on American Recovery and Reinvestment Act of 2009 (Recovery Act) funds expended for certain benefits paid under the Unemployment Insurance (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. 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.

Status of Corrective Action: Fully Corrected. The programming for the financial management systems to identify and report on Recovery Act funds related to the benefit expenditures (known as BAG reports) has been completed, tested, and was released for EDD's use in March 2013. EDD is currently in the process of re-running the expenditure reports prior to March 2013 to properly report on the Recovery Act funds. The re-run process is expected to be completed by October 2013. Once that process has been completed, accounting staff will complete the analysis of the data.

EDD is still working on the portion of the reports that capture overpayment information (known as OARG reports) in order to identify and report that Recovery Act fund activity. There are separate overpayment reports that capture daily, weekly, and monthly information. The reports that capture the daily and weekly overpayment information have been programmed, tested, and were released for EDD's use in May 2013. Changes to the reports that capture the monthly overpayment information have been programmed, tested, and were released for EDD's use as of the beginning of July 2013. EDD is currently in the process of preparing to re-run the OARG reports prior to July 2013 and will begin that re-run process shortly so that EDD can properly report on the Recovery Act funds.

Reference Number: 2011-12-11

Federal Program: 17.258
17.259
17.278

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting. EDD did not have a process in place to comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for the Workforce Investment Act cluster. Failure to implement adequate controls over FFATA reporting increases the risk of late or nonsubmission of subaward information.

Status of Corrective Action: Fully Corrected. EDD published the FFATA Directive WSD 12-11 on January 18, 2013. The purpose of the directive is to provide guidance to federally funded subawardees and subcontractors on FFATA reporting requirements.

Auditors' Comment: We reported a similar finding in the 2013 audit due to the fact that EDD was not in compliance during the full year. Please refer to finding 2013-018.

Reference Number: 2011-12-12

Federal Program: 17.258
17.259
17.278

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. 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. Of 22 audits tested, 2 were found in which the management letter was not issued within six months of the receipt of the subrecipient's OMB Circular A-133 reports. Failure to comply with timely issuance of management decisions on audit findings will not allow the subrecipient to take appropriate and timely corrective action.

Status of Corrective Action: Fully Corrected. Procedural changes have been made to ensure letters are issued timely. All management decision letters have been issued on time for the current period.

Auditors' Comment: We reported a similar finding in the 2013 audit due to the fact that EDD was not in compliance during the full year. Please refer to finding 2013-016.

Reference Number: 2012-12-13

Federal Program: 17.258
17.259
17.278

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. EDD did not ensure its subrecipients provided Data Universal Numbering System (DUNS) numbers prior to awarding Workforce Investment Act funds. EDD was unaware of these requirements and, as a result, did not implement a process to inform its subrecipients of the requirement.

Status of Corrective Action: Fully Corrected. EDD has resolved this finding by adding the request for DUNS number to the "Subgrantee Employee Identification Number" form that the Workforce Services Branch sends out with the Workforce Investment Act Title 1 – Youth Subgrant Award packages. EDD requires subgrantees return this form prior to funding.

Auditors' Comment: We reported a similar finding in the 2013 audit due to the fact that EDD was not in compliance during the full year. Please refer to finding 2013-017.

Reference Number: 2012-12-14

Federal Program: 20.205 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Audit Finding: Cash Management, Matching, and Reporting. Caltrans information technology (IT) general controls over its accounting system were not properly designed. Lack of adequate IT controls could result in inappropriate access and unauthorized changes to the system. In addition, Caltrans also 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.

Status of Corrective Action: Fully Corrected. Caltrans identified key roles and user profiles for the Advantage System. Role managers were designated and are responsible for providing secondary approval (in addition to supervisory approval) for access to the key roles and user profiles. Caltrans implemented a policy for periodic review of employees' assigned access to the Advantage System. This policy requires quarterly reviews by managers and/or supervisors. Caltrans also implemented changes to ensure that each system administrator has a unique ID which can be used to identify changes in the production environment. In addition, Caltrans has implemented a change in which development staff do not have access to the production environment and are unable to change production code.

Auditors' Comment: Caltrans implemented the prior year recommendations; however, we identified other deficiencies in general IT controls. Please refer to finding 2013-021.

Reference Number: 2012-12-15

Federal Program: 20.205 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. Caltrans did not have a process in place to obtain Data Universal Numbering System (DUNS) numbers from its subrecipients prior to awarding Highway Planning and Constructions funds. As a result, subrecipients were not aware of the requirement to provide their DUNS number to Caltrans.

Status of Corrective Action: Fully Corrected. Caltrans has notified 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.

Reference Number: 2012-12-16

Federal Program: 81.041 (ARRA)

State Administering Department: California Energy Commission (Energy Commission)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Cash Management. The Energy Commission did not have adequate controls in place to ensure cash management requirements were met for the State Energy Program. Of 16 cash draws tested, it was found that the Energy Commission disbursed funds for two draws well after the funds were received from the federal government. The Energy Commission also did not have a policy in place to track and remit interest earned to the federal government. Finally, the Energy Commission did not have proper segregation of duties in place when submitting cash draw requests to the federal government until November 2012. Lack of segregation of duties could result in improper amounts drawn from the federal government.

Status of Corrective Action: Fully Corrected. The Energy Commission has documented and implemented new procedures for drawing and reconciling funds. Cash draws are reviewed, signed and dated by the Accounting Administrator which provides better oversight and segregation of duties. The Energy Commission cannot remit interest earned on drawn federal funds because no interest was earned on them. The United States Department of Education was notified of this fact and acknowledged and accepted the fact that interest was not earned and therefore could not be remitted back to them.

Reference Number: 2012-12-17

Federal Program: 81.041

State Administering Department: California Energy Commission (Energy Commission)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting. The Energy Commission does not have proper controls in place to evidence its review of the Federal Financial Report (SF-425), prior to submission. Failure to maintain adequate controls increases the risk that the Energy Commission may report inaccurate information to the federal government.

Status of Corrective Action: Fully Corrected. The Grants and Loans Officer now reviews, signs and dates the SF-425 reports before the Accounting Officer submits them to the United States Department of Education.

Reference Number: 2012-12-18

Federal Program:
84.011
84.027
84.173
84.048
84.287
84.365
84.367
84.377
10.553
10.555
10.556
10.559
10.558
93.575
93.596

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Reporting. 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 did not report information for each of its other programs. Furthermore, Education did not have adequate controls to ensure the subaward information was accurate. More specifically, Education did not include one local education agency in the report due to insufficient Data Universal Numbering System (DUNS) documentation.

Status of Corrective Action: Partially Corrected. Education is currently testing the submission process for the other federal programs and will report subaward information once deemed successful; Education expects this process to be completed in September 2013. In addition, Education is working to incorporate the FFATA requirements in its Funding Handbook.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-029.

Reference Number: 2012-12-19

Federal Program: 84.010
84.389 (ARRA)
93.575
93.596

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2005-06

Audit Finding: Subrecipient Monitoring. Education lacks adequate controls over monitoring of local education agencies (LEAs) participating in Title I grants and Child Care and Development Grant Programs. Education also lacks evidence of review by a Regional Team Lead over the on-site monitoring visit and related findings. Additionally, 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 its subrecipients are approaching the due date for corrective actions so that Education can perform a follow-up. 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.

Status of Corrective Action: Fully Corrected. An automated notification in the California Accountability Improvement System was established for the 2012-13 school year that notifies LEA staff and program reviewers 10 days prior to the 45-day deadline to resolve findings. In addition, program managers are provided with a list of unresolved findings at monthly Federal Program Monitoring (FPM) Program Managers Meetings to follow up with LEAs and ensure that Resolution Agreement deadlines do not exceed a total of 225 calendar days. These corrective actions have been incorporated in the FPM Protocols.

Reference Number: 2012-12-20

Federal Program: 84.011

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting and Special Tests and Provisions. Education uses the Migrant Student Information Network (MSIN) to collect child count data, which is then submitted 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. Education lacks adequate controls to review and evaluate the information; as a result, Education may not report accurate information to the federal government.

Status of Corrective Action: Partially Corrected. Education established a monthly process for May, August, and September whereby it plans to continue matching MSIN and California Longitudinal Pupil Achievement Data System (CALPADS) data to obtain Statewide Student Identifier (SSID) information. After three months of matching, Education will establish a quarterly schedule to conduct SSID matching with CALPADS. Education is also taking other steps that will lay the foundation for the collection of accurate program service and outcome data. Education will implement a year-long process beginning in fiscal year (FY) 2013–14 to standardize the service codes utilized by migrant regions when entering service data into the Certificate of Eligibility (COEstar) database.

During FY 2013–14, Education will also take other steps to ensure that the corrective actions taken to this recommendation are focused on addressing all data needs. The first step will include the hiring of a consultant to conduct a gap analysis of data needs and services as well as a study of viable options/solutions that exist both in-state and out-of-state. The second step will include a review of the consultant's findings and the selection of a course of action regarding a data-collection solution, either newly-designed or existing.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-030.

Reference Number: 2012-12-21

Federal Program: 84.027
84.391 (ARRA)

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Level of Effort – Maintenance of Effort. Education lacks adequate controls to ensure maintenance of effort (MOE) requirements are met. Education's MOE expenditures for the 2009-10 fiscal year was $83,464,446 less than its 2008-09 federal fiscal year expenditures. Unless a waiver is received from the federal government, Education could be subject to a reduction of federal funding.

Status of Corrective Action: Partially Corrected. To meet the federal Special Education MOE requirements for fiscal year (FY) 2009-10, Education submitted a request for Proposition 98 General Fund which was included in the Department of Finance's April Letter to the budget committees. The Education omnibus trailer bill, Assembly Bill (AB) 86 (Chapter 48), Section 84, provided the funding to meet the FY 2009-10 MOE. AB 86 was approved by the Governor and filed with the Secretary of State on July 1, 2013.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-032.

Reference Number: 2012-12-22

Federal Program: 84.048

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Level of Effort – Maintenance of Effort. Education lacks adequate controls over evaluation of the maintenance of effort (MOE) requirements of the Career and Technical Education Program. More specifically, Education cannot ensure the completeness and accuracy of amounts reported by local educational agencies. Without accurate amounts from subrecipients, Education cannot ensure compliance with MOE requirements.

Status of Corrective Action: Fully Corrected. In the last year, Education has initiated and engaged in efforts to increase the local education agencies' awareness over the importance of reporting expenditures accurately. Education will continue to provide technical assistance and training as part of regional and statewide conferences, meetings and forums. Additionally, Education will continue to provide technical assistance as part of monitoring visits and as requested by subrecipients. Education will continue to monitor subrecipients' reporting practices to ensure accuracy and completeness. Feedback from subrecipients indicates that reporting practices have improved statewide.

Reference Number: 2012-12-23

Federal Program: 84.048

State Administering Department: California Community Colleges Chancellor's Office (CCCCO)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. CCCCO lacks adequate controls to monitor subrecipients and is not in compliance with federal requirements. Specifically, CCCCO does not provide the Catalog of Federal Domestic Assistance (CFDA) number for the Career and Technical Education (CTE) Program to the community college districts in grant awards or other communications. CCCCO also lacks adequate controls to monitor the use of federal awards through site visits, limited scope audits, or other means. Finally, CCCCO lacks adequate controls to obtain and review the OMB A-133 audits of community college districts and follow up on findings related to the CTE grant.

Status of Corrective Action: Partially Corrected. The CCCCO communicates the CFDA number to community college districts on each grant application and award letter. Additionally, the CFDA number is posted at the login page of all applications and quarterly expenditure reports of the Carl Perkins online reporting system. The CCCCO developed a risk-based monitoring system, selection process, and monitoring tool that includes a desk review and on-site monitoring for those districts that meet established risk criteria. The CCCCO established and implemented a process to review the OMB A-133 audits of community college districts and follow up with those districts to ensure that Carl D. Perkins related findings have been corrected.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-031.

Reference Number: 2012-12-24

Federal Program: 84.126
84.390 (ARRA)

State Administering Department: Department of Rehabilitation (Rehabilitation)

Fiscal Year Initially Reported: 2008-09

Audit Finding: Eligibility. Rehabilitation lacks adequate controls to determine applicant eligibility for services within the required 60-day time period. Out of 65 applicant cases tested, it was found that six cases were not determined eligible within the 60-day time period. In addition, Rehabilitation lacks adequate controls to develop an Individual Plan for Employment (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.

Status of Corrective Action: Partially Corrected. Districts 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. Counselors are provided with their respective caseload report/list of consumers requiring eligibility determination and IPE development. Team managers take appropriate action to ensure that eligibility and IPE timelines have been met, including the meeting of timelines for applicable extensions. Actions include reviewing Senior Vocational Rehabilitation Counselors (SVRC) - Qualified Rehabilitation Professional (QRP) caseload reports; identifying and communicating to SVRC-QRPs respective cases requiring action; monitoring and tracking SVRC-QRP effectiveness in meeting regulatory case timelines and implement corrective action as appropriate. Monthly AWARE report(s) for consumers with overdue eligibilities or IPE’s are generated for each District and provided to the district administrators (DAs). Technical assistance and guidance is provided to the DAs to rectify specific District/Unit/counselor issues related to timely eligibility determination and IPE development (e.g. CSU Manager technical guidance and instruction related to: a) electronic case recording system, AWARE, report generation and customization; b) development of “managed layout/reports specific to district needs; c) interpretation of AWARE reports/data for district and statewide). The DAs work with the Personnel Services Section to implement corrective actions, as appropriate. A summary report on District timely eligibility and IPEs is provided to the Vocational Rehabilitation Employment Division Deputy Director monthly.

Auditors’ Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-033.

Reference Number: 2012-12-25

Federal Program: 84.389 (ARRA)
84.391 (ARRA)
84.392 (ARRA)

State Administering Department: California Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Reporting. 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. Although Education prepares the report from information maintained by program personnel, the information is not reconciled to the accounting records, such as the general ledger. Education also needs to ensure that the Section 1512 report is reviewed for accuracy prior to submission.

Status of Corrective Action: Fully Corrected. Per the U.S. Department of Education, Office of Elementary and Secondary Education’s (OESE) determination, Education has taken sufficient steps to address the problems cited in the finding and does not require further documentation.

Auditors’ Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-039.

Reference Number:	2012-12-26
Federal Program:	84.377 84.388 (ARRA)
State Administering Department:	California Department of Education (Education)
Fiscal Year Initially Reported:	2010-11
Audit Finding:	Subrecipient Monitoring. Education lacks adequate controls over monitoring of local educational agencies (LEAs) participating in the School Improvement Grant program. Education lacks evidence of review by a supervisor over the on-site monitoring visit and related findings. Furthermore, Education lacks adequate controls to ensure LEAs implement proposed corrective actions in a timely manner on deficiencies noted. Finally, Education does not have a tracking mechanism to determine when LEAs are approaching the due date for corrective actions so that a follow-up can be performed.
Status of Corrective Action:	Fully Corrected. An automated notification in the California Accountability Improvement System was established for the 2012-13 school year that notifies LEA staff and program reviewers 10 days prior to the 45-day deadline to resolve findings. In addition, program managers are provided with a list of unresolved findings at monthly Federal Program Monitoring (FPM) Program Managers Meetings to follow up with LEAs and ensure that Resolution Agreement deadlines do not exceed a total of 225 calendar days. These corrective actions have been incorporated in the FPM Protocols.

Reference Number:	2012-12-27
Federal Program:	10.553 10.555
State Administering Department:	California Department of Education (Education)
Fiscal Year Initially Reported:	2009-10
Audit Finding:	Procurement, Subrecipient Monitoring. Education did not implement appropriate internal controls and procedures to ensure that the approval process of food service management company contracts was documented prior to reimbursing subrecipients.
Status of Corrective Action:	Partially Corrected. To ensure compliance with federal requirements prior to sub-recipients' application renewal and reimbursement of federal funds, Education's School Food Service Contracts Unit (SFSCU) reviews and approves food service management company contracts submitted to Education; SFSCU approvals are documented in Child Nutrition Information and Payment System.
Auditors' Comment:	We reported a similar finding in the 2013 audit. Please refer to finding 2013-003.

Reference Number: 2012-12-28

Federal Program: 93.044
93.045
93.053

State Administering Department: Department of Aging (Aging)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting. Aging lacks adequate controls to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) was properly reported. Aging also lacks controls to ensure FFATA reporting information is submitted in a timely manner. Failure to implement adequate controls over FFATA increases the risk that inaccurate or incomplete information will be reported.

Status of Corrective Action: Fully Corrected. Aging has procedures in place that was 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.

Reference Number: 2012-12-29

Federal Program: 93.268
93.712 (ARRA)

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Reporting. 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. Failure to reconcile spreadsheets to final submission increases the risk of errors in information reported to the federal government.

Status of Corrective Action: Fully Corrected. The Federal Financial Reports (FFR) procedures were revised in February to require reviews by two levels of supervisors and a reconciliation of the amounts listed on the FFR to CALSTARS reports. The Accounting Section now uses an FFR checklist as part of the reviews and this checklist is filled with the FFR and matching CALSTARS reports in the grant folder.

Reference Number: 2012-12-30

Federal Program: 93.268
93.712 (ARRA)

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 policies and procedures to ensure Quality Assurance Reviews (QARs) are performed and properly documented. Out of 40 QAR reports tested, 10 were identified as being incomplete. 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.
Status of Corrective Action:	Fully Corrected. The California Vaccines for Children (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. The VFC Program Coordinator will continue to provide monthly training and updates to all field staff. As of February 2013, this training addresses 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. As of March 1, 2013, senior field representatives 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. As of March 1, 2013, field staff 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. 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. Public Health will implement this electronic entry of site visit results in fall 2013.

Reference Number:	2012-12-31
Federal Program:	93.558 93.714 (ARRA)
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2011-12

Audit Finding: Subrecipient Monitoring. Social Services did not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements. Social Services did not 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. Social Services also did not perform all planned site visits during fiscal year 2011-12. Finally, Social Services lacks policies and procedures to assess Temporary Assistance for Needy Families eligibility determinations, redeterminations, and termination of benefits made by the counties as well as other special test and provisions as part of the risked-based monitoring plan. Failure to properly monitor subrecipients increases the risk that federal monies will be paid for unallowable costs.

Status of Corrective Action: Fully Corrected. Regarding the third recommendation, an update to the 60 day corrective action plan is needed as the initial case review plan was found to be too aggressive for the review of the eligibility criteria. The California Work Opportunity and Responsibility to Kids (CalWORKs) Eligibility Bureau is continuing to develop a case review tool for the on-site review of CalWORKs cases. The review tool will help Social Services ensure County Welfare Departments (CWDs) are properly determining eligibility, both at application and annual redetermination, and will also assess whether benefits were correctly terminated. More specifically, the review tool includes an analysis of the following factors of CalWORKs eligibility: residency of the family; child deprivation; family income; family resources; immigration status of all family members; the composition of the assistance unit (i.e., whether everyone receiving aid is eligible for aid, including whether the maximum family grant rule is applicable); and the grant calculation, including recoupment of any applicable overpayments.

Additional factors the review tool examines include cooperation with child support requirements, whether the case has all required documentation on file, and whether clients were given timely and adequate notice with respect to adverse case actions. The review tool will provide Social Services staff with guidance, based on CalWORKs regulations, to determine whether the aforementioned eligibility factors are applied correctly in the case file. Social Services is working with county partners, including the County Welfare Directors Association, to solicit feedback on the review tool. Social Services anticipates the review tool will be completed by the end of calendar year 2013.

As to Social Services' monitoring strategy, a risk-based auditing plan is under development. As such, Social Services intends to conduct 100 case reviews annually. The cases will be randomly sampled and proportioned to represent the state: Los Angeles, the remaining Performance Monitoring Counties (i.e., the 18 largest counties in the state), and the smaller counties. The sample will be weighted.

The 100 annual case reviews will not all be on-site reviews. Some will be on-site, whereas the remainder will be conducted off-site electronically or via desk reviews. Actual on-site reviews will commence in calendar year 2014. For each on-site visit, five to eight case reviews will be conducted.

With regard to county surveys, recent legislation revised various CalWORKs rules. Specifically, changes will be made to grant levels, earned income disregard and vehicle asset limit. These three changes are set to occur at different times between October 1, 2013 and March 1, 2014. Social Services intends to survey CWDs, along with the Statewide Automation Welfare Systems (SAWS) responsible for programming the changes, to ensure the changes are correctly implemented. Written responses from CWDs, and SAWS consortia will be requested and reviewed. Social Services is in the process of developing the county surveys. The anticipated completion date is March 2014. Social Services intends to complete the combination of county surveys and desk reviews by the end of calendar year 2014.

Reference Number:	2012-12-32
Federal Program:	93.659
State Administering Department:	Department of Social Services (Social Services)
Fiscal Year Initially Reported:	2011-12
Audit Finding:	Eligibility. Social Services does not have adequate controls to ensure eligibility determinations were appropriate and benefits paid were accurate. Social Services should strengthen its policies and procedures for eligibility to ensure all documentation is included in the case file and benefit amounts and determination dates are properly entered into the system.

Status of Corrective Action:

Fully Corrected. Social Services has addressed the finding and the recommendation has been partially implemented as of January 16, 2013. Full implementation was 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 numerous 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.

Reference Number: 2012-12-33

Federal Program:
93.658
93.659
93.558
93.667

State Administering Department: Department of Social Services (Social Services)

Fiscal Year Initially Reported: 2011-12

Audit Finding:

<u>Reporting</u>. Social Services did not comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA). Social Services lacks policies and procedures to report subaward information under the FFATA and lacks controls to ensure information is accurate and complete.

Status of Corrective Action: Partially Corrected. After verbal discussions with the Administration for Children and Families (ACF) Region IX, Social Services submitted a plan to achieve compliance with the FFATA requirements to ACF in August 2013. The proposed methodology is consistent with what is currently being utilized to report FFATA for the Supplemental Nutrition Assistance Program administrative expenditures.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-040.

Reference Number: 2012-12-34

Federal Program: 93.959

State Administering Department: Department of Alcohol and Drug Programs (ADP)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. 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. During fiscal year 2012, ADP performed only three site visits, which covered less than 5 percent of monies disbursed by ADP. Failure to properly monitor subrecipients increases the risk the federal monies will be paid for unallowable costs.

Status of Corrective Action: Fully Corrected.

Fiscal policies and procedures to monitor subrecipients. ADP disagrees with the audit finding indicating it does not have adequate fiscal policies and procedures to monitor subrecipients to ensure the 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 Office of Management and Budget (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 year's Single Audit findings (FY 2007-08 and FY 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 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 Substance Abuse Prevention and Treatment (SAPT) Block Grant funds in accordance with applicable laws and regulations [45 CFR 96.31 (b)].

For the 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 fiscal year 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 CAP 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.

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 ADP's audit selection methodology and outlined in the 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 risk 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 on-site audit team and the senior audit manager that the quality 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.

I*mplementation date for corrective action plan*. ADP revised its risk-based monitoring plan by April 2, 2013. Completion of all scheduled site visits in accordance with the risk-based audit plan will be determined by Health Care Services on or after July 1, 2013.

Reference Number: 2012-12-35

Federal Program:
93.720
93.775
93.777
93.778
93.767

State Administering Department: Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Activities Allowed/Allowable Costs. Health Care Services does not have policies and procedures in place to ensure Information Technology general controls are operating effectively so that 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 also lacks policies and procedures to ensure program changes are approved by authorized individuals prior to implementation.

Status of Corrective Action: Partially Corrected. Release I has been implemented. Release II is scheduled for an October 2013 implementation and a new release III is scheduled to implement after release II.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-042.

Reference Number: 2012-12-36

Federal Program:
93.720
93.775
93.777
93.778

State Administering Department: Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported: 2011-12

Audit Finding: Subrecipient Monitoring. Health Care Services did not communicate to county welfare departments as to how federal compliance requirements related to internal control and compliance objectives for Medicaid eligibility were to be addressed in the county single audit. As a result, county single audits have not addressed eligibility compliance for all Medicaid beneficiaries.

Status of Corrective Action: Remains Uncorrected. Health Care Services continues to work with relevant parties, including county welfare departments to ensure federal requirements related to internal control and compliance objectives to Medicaid eligibility are properly addressed county single audits.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-041.

Reference Number: 2012-12-37

Federal Program:
93.720
93.775
93.777
93.778

State Administering Department: Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported: 2008-09

Audit Finding: <u>Subrecipient Monitoring</u>. Health Care Services lacks adequate policies, procedures and monitoring for county eligibility determinations.

Status of Corrective Action: Partially Corrected. Of the four corrective actions Health Care Services agreed to perform, all have been completed with the exception of #3, which is to issue an All County Welfare Director's Letter 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. Health Care Services anticipates completing this last corrective action within 30 days.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-044.

Reference Number: 2012-12-38

Federal Program:
93.720
93.775
93.777
93.778

State Administering Department: Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported: 2009-10

Audit Finding: <u>Subrecipient Monitoring</u>. Health Care Services does not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements.

Status of Corrective Action: Partially Corrected. All local governmental agencies (LGAs) and local educational consortias (LECs) were notified either by email or through a Policy and Procedure Letter of this requirement. To date, 33 contractual agreements have been amended. The remaining 41 contractual agreements will be amended by November 30, 2013.

In April 2011, Health Care Services imposed travel restrictions and all site visits were halted. In fiscal year (FY) 2012-13, Health Care Services rescinded the travel restrictions and site visits were resumed. During FY 2012-13, all but 4 required Medi-Cal Administrative Activities (MAA) program site visits were completed. The remaining 4 site visits will be conducted in FY 2013-14. By June 30, 2014, all required MAA site visits will be conducted in accordance with department policy.

In April 2011, Health Care Services imposed travel restrictions and all site visits were halted. In fiscal year (FY) 2012-13, Health Care Services rescinded the travel restrictions and site visits were resumed. During FY 2012-13, all but 4 required Medi-Cal Administrative Activities (MAA) program site visits were completed. The remaining 4 site visits will be conducted in FY 2013-14. By June 30, 2014, all required MAA site visits will be conducted in accordance with department policy.

Health Care Services' proposed concept to develop an attachment to MAA program invoice requiring LGA/LEC claiming units to identify the amounts passed through to subrecipients has been deemed an ineffective method of obtaining and monitoring this information. Health Care Services has developed an annual Policy and Procedure Letter, wherein the LGA/LEC claiming units will be required to submit this information to Health Care Services annually upon the close of each fiscal year. This concept will be implemented by Health Care Services by November 30, 2013.

All LGAs and LECs were notified by email and through a Policy and Procedure Letter of this requirement. To date, 33 contractual agreements have been amended. The remaining 41 contractual agreements will be amended by November 30, 2013.

Health Care Services is still in the process of updating and revising the Department's current policies and procedures regarding the OMB Circular A-133 reports for all subrecipients claiming amounts more than $500,000. Added written policies and procedures will include the following: 1.) Standard protocol for receiving all A-133 reports from the State Controller's Office (SCO) relating to Medicaid funding. This will include OMB Circular A-133 reports for local government agencies and local education consortiums. In order to establish protocol, Health Care Services is currently corresponding with the State Controller's Office. 2.) Steps to ensure that policies and procedures are in place for reviewing the recommended corrective action plans (CAP). 3.) Ensure that steps are established for Health Care Services to follow up on the management letters sent to the subrecipients who need corrective action. This will include additional steps for Health Care Services to ensure that the CAP is fully corrected in accordance to their Single Audit report. 4.) Department's disciplinary action procedures to apply for subrecipients who fail to implement the CAP in a timely manner. The revised policies and procedures will be implemented by November 30, 2013.

Auditors' Comment: We reported a similar finding in the 2013 audit. Please refer to finding 2013-045.

Reference Number: 2012-12-39

Federal Program: 93.720
93.775
93.777
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 lacks adequate policies and procedures to strengthen and complete its efforts to re-enroll all active Medicaid providers to ensure that all providers have a provider agreement in place and that the required provider agreements are maintained.

Status of Corrective Action: Partially Corrected. Health Care Services 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 in order to retain Medi-Cal eligibility. Health Care Services 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. Health Care Services 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 Health Care Services continues to work toward completing the re-enrollment of all providers every five years to the extent that resources allow. Health Care Services also continues to examine and strengthen its policies and procedures to ensure that the required provider agreements and supporting documents are maintained in its document management system.

Auditors' Comment: The finding was not repeated in the 2013 audit as Health Care Services has taken sufficient action to address the finding.

Reference Number: 2012-12-40

Federal Program: 93.720
93.775
93.777
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. 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. Of the claims tested, one claim was reimbursed to the provider for both the CTA and CT. Based upon current policy, this claim should have been denied for one of the procedures.

Status of Corrective Action: Fully Corrected. The modified policy was implemented on 7/1/13 via Operating Instruction Letters 245c-05 and 245d-05 retroactive to 5/1/13. As a result, the problem is corrected. Health Care Services has initiated Erroneous Payment Correction 14451 to reprocess those claims falling within the retroactive period. Any claim paid in error will be corrected retroactively.

Reference Number: 2012-12-41

Federal Program:	93.720 93.775 93.777 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 an adequate internal controls process to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent unauthorized use of identification numbers. Furthermore, Health Care Services lacks procedures to authenticate the existence of the recipient, prevent duplicate issuances, and reconcile the presumptive eligibility number against the recipient enrollment listing field at Health Care Services during the claims adjudication process.
Status of Corrective Action:	Partially Corrected. Health Care Services agrees with the recommendations, however lacks the necessary resources needed to develop and implement automation of the enrollment of patients into the presumptive eligibility program.
Auditors' Comment:	The finding was not repeated in the 2013 audit as Health Care Services has taken sufficient action to address the finding.

Reference Number:	2012-12-42
Federal Program:	97.067
State Administering Department:	California Emergency Management Agency (Cal EMA)
Fiscal Year Initially Reported:	2011-12
Audit Finding:	Reporting. Cal EMA did not have adequate controls in place to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) was properly reported. Cal EMA did not review FFATA information prior to submission. Additionally, while Cal EMA did made attempts to submit subaward information, they 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.
Status of Corrective Action:	Fully Corrected. Cal EMA implemented a new process to correct the finding. New controls were put into place to ensure information was properly reported, with several rounds of review and approval. FFATA information is initially reviewed by program representative through the Grant Award Facesheet and FFATA tab in the Financial Management Forms Workbook. FFATA information is entered into the fsrs.gov website, with a draft of the report created. This draft report goes through a review with another staff member, then a final managerial review and approval. The approved report is then submitted on fsrs.gov within 30 days of award obligation.

Response to the Audit - Department of Finance

DEPARTMENT OF
FINANCE
OFFICE OF THE DIRECTOR

EDMUND G. BROWN JR. ▪ GOVERNOR
STATE CAPITOL ▪ ROOM 1145 ▪ SACRAMENTO CA ▪ 95814-4998 ▪ WWW.DOF.CA.GOV

April 21, 2014

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, 2013. This report was the result of your examination of the state's administration of federal programs for the fiscal year ended June 30, 2013, 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 20 unqualified opinions and 10 qualified opinions for the 30 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 2012-13 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.

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 Rick Sierra, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,

MICHAEL COHEN
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