

# 2013-14

## Single Audit Report



# **2013-14 Single Audit Report**



**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](http://WWW.DOF.CA.GOV)

March 30, 2015

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, 2014. 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 three material weaknesses and one significant deficiency, 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 there are areas where internal controls and administration of federal awards need to be improved, and we are taking steps to address these issues. This year's combined results of the Single Audit Report identified an overall reduction of findings signifying improvements in California's operations.

California provides its citizens with numerous state and federal programs and activities and is more complex and vast 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, these 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.

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 state is committed to sound and effective fiscal oversight.

Individual departments have separately responded to the Single Audit Report findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. The combined results of the Single Audit Report will be disseminated to all departments and Finance will remind departments of their responsibility for implementing corrective action plans. Further, we will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

Mr. Daniel R. Levinson  
March 30, 2015  
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The Financial Integrity and State Manager's Accountability Act (FISMA) specifies 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. 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.

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 into consideration the findings reported in the Single Audit Report during the course of our work.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Cohen", with a long, sweeping horizontal line extending to the right.

MICHAEL COHEN  
Director

Enclosure



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# **Part One**

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**State of California Financial Report  
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## *Independent Auditor's Report*

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### 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, 2014, 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 financial statements of the following:

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

- Certain enterprise funds that, in the aggregate, represent 79 percent of the assets and deferred outflows, and 30 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 93 percent of the revenues of the discretely presented component units.

##### *Fund Financial Statements*

- The Safe Drinking Water State Revolving fund, that represents 15 percent of the assets and deferred outflows, and 6 percent of the additions, revenues, and other financing sources of the Environmental and Natural Resources fund, a major governmental fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, State Lottery fund, and California State University fund.
- The Golden State Tobacco Securitization Corporation, the Public Building Construction, 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 58 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 solely 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 accounting estimates made by management, as well as evaluating the overall 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, 2014, 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 a discussion and analysis by management, schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances, and related notes be presented to supplement the basic financial statements. 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 our 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 basic 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 performed 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 have also issued our report dated March 19, 2015 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

A handwritten signature in black ink, reading "John F. Collins II". The signature is fluid and cursive, with a stylized "J" and "C".

JOHN F. COLLINS II, CPA  
Deputy State Auditor

March 19, 2015

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# Management's Discussion and Analysis

The following Management's Discussion and Analysis is required supplementary information 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, 2014. 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

California experienced a solid rebound in economic activity during the 2013-14 fiscal year and its financial health is clearly on the mend. The State's general revenues increased by \$7.1 billion (6.0%) over the prior year. Expenses for the State's governmental activities also increased but were less than revenues received, resulting in a \$7.8 billion increase in the governmental activities' net position and yielding the first positive net position since the 2008-09 fiscal year. Total revenues and transfers for the State's business-type activities also surpassed expenses by \$1.9 billion in fiscal year 2013-14.

*Net Position* – The primary government's net position as of June 30, 2014, was \$7.3 billion. The total net position is reduced by \$96.1 billion for net investment in capital assets and by \$29.8 billion for restricted net position, yielding a negative unrestricted net position of \$118.6 billion. Restricted net position is dedicated for specified uses and is not available to fund current activities. More than half of the negative \$118.6 billion consists of \$66.7 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net position; however, local governments, not the State, own the capital assets that would offset this reduction.

### Fund Highlights

*Governmental Funds* – As of June 30, 2014, the primary government's governmental funds reported a combined ending fund balance of \$19.8 billion, an increase of \$8.1 billion over the prior fiscal year, as restated. The unrestricted fund balance, comprised of committed, assigned, and unassigned balances, was negative \$5.1 billion. The nonspendable and restricted fund balances were \$156 million and \$24.7 billion, respectively.

*Proprietary Funds* – As of June 30, 2014, the primary government's proprietary funds reported a combined ending net position of \$5.9 billion, an increase of \$1.7 billion over the prior fiscal year, as restated. The total net position is reduced by \$2.3 billion for net investment in capital assets, expendable restrictions of \$5.2 billion, and nonexpendable restrictions of \$16 million, yielding a negative unrestricted net position of \$1.6 billion.



## Noncurrent Assets and Liabilities

As of June 30, 2014, the primary government's noncurrent assets totaled \$145.4 billion, of which \$125.1 billion is related to capital assets. State highway infrastructure assets of \$65.3 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled \$161.0 billion, which consists of \$79.9 billion in general obligation bonds, \$30.3 billion in revenue bonds, and \$50.8 billion in remaining noncurrent liabilities. During the 2013-14 fiscal year, the primary government's noncurrent liabilities decreased by \$3.3 billion (2.0%) from the prior fiscal year. This decrease was primarily the result of a \$4.4 billion decrease in capital lease obligations, an increase of \$3.2 billion in net other postemployment benefits obligations, a decrease of \$1.3 billion in revenue bonds payable, and a \$952 million decrease in loans payable.

## 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 financial and capital resources in a format in which assets and deferred outflows of resources equal liabilities and deferred inflows of resources, plus 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 general government, education (public kindergarten through 12th grade [K-12] schools and institutions of higher education), health and human services, resources, state and consumer services, business and transportation, correctional programs, 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 services to California State University students, 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 are blended component units of the State and are included in 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 California Public Employees' Retirement System and the California 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.

Most component units prepare their own separately issued financial statements. For information regarding obtaining the financial statements of the individual component units, refer to Note 1A, Reporting Entity.

## 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 public building construction, 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 position (governmental and business-type activities) increased by more than 409%, from a negative \$2.4 billion, as restated at June 30, 2013, to a positive \$7.3 billion a year later.

The primary government's \$96.1 billion net 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 to pay off the liabilities.

Another \$29.8 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, 2014, governmental activities reported an unrestricted net deficit of \$116.9 billion and business-type activities showed an unrestricted net deficit of \$1.7 billion.

A large portion of the unrestricted net deficit of governmental activities consists of \$66.7 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the related bonded debt is included in the portion of net position reported as “net investment in capital assets.” Instead, the bonded debt is reported as a noncurrent liability that increases the State’s unrestricted net position deficit. The State can expect continued deficits in the unrestricted net position of governmental activities as long as it 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, 2014 and 2013

(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2014	2013	2014	2013	2014	2013
<b>ASSETS</b>						
Current and other assets .....	\$ 70,798	\$ 55,358	\$ 24,345	\$ 34,996	\$ 95,143	\$ 90,354
Capital assets .....	116,369	108,668	8,735	9,959	125,104	118,627
<b>Total assets .....</b>	<b>187,167</b>	<b>164,026</b>	<b>33,080</b>	<b>44,955</b>	<b>220,247</b>	<b>208,981</b>
<b>DEFERRED OUTFLOWS</b>						
<b>OF RESOURCES .....</b>	<b>986</b>	<b>911</b>	<b>242</b>	<b>480</b>	<b>1,228</b>	<b>1,391</b>
<b>Total assets and deferred</b>						
<b>outflows of resources .....</b>	<b>\$ 188,153</b>	<b>\$ 164,937</b>	<b>\$ 33,322</b>	<b>\$ 45,435</b>	<b>\$ 221,475</b>	<b>\$ 210,372</b>
<b>LIABILITIES</b>						
Noncurrent liabilities .....	\$ 137,522	\$ 128,052	\$ 23,506	\$ 36,282	\$ 161,028	\$ 164,334
Other liabilities .....	48,456	44,863	3,676	4,616	52,132	49,479
<b>Total liabilities .....</b>	<b>185,978</b>	<b>172,915</b>	<b>27,182</b>	<b>40,898</b>	<b>213,160</b>	<b>213,813</b>
<b>DEFERRED INFLOWS</b>						
<b>OF RESOURCES .....</b>	<b>171</b>	<b>159</b>	<b>823</b>	<b>471</b>	<b>994</b>	<b>630</b>
<b>Total liabilities and deferred</b>						
<b>inflows of resources .....</b>	<b>186,149</b>	<b>173,074</b>	<b>28,005</b>	<b>41,369</b>	<b>214,154</b>	<b>214,443</b>
<b>NET POSITION</b>						
Net investment in capital assets .....	94,001	84,931	2,066	1,719	96,067	86,650
Restricted .....	24,951	24,316	4,913	5,172	29,864	29,488
Unrestricted .....	(116,948)	(117,384)	(1,662)	(2,825)	(118,610)	(120,209)
<b>Total net position (deficit) .....</b>	<b>2,004</b>	<b>(8,137)</b>	<b>5,317</b>	<b>4,066</b>	<b>7,321</b>	<b>(4,071)</b>
<b>Total liabilities, deferred inflows</b>						
<b>of resources, and net position .....</b>	<b>\$ 188,153</b>	<b>\$ 164,937</b>	<b>\$ 33,322</b>	<b>\$ 45,435</b>	<b>\$ 221,475</b>	<b>\$ 210,372</b>

**Changes in Net Position**

The expenses of the primary government totaled \$237.1 billion for the year ended June 30, 2014. Of this amount, \$120.5 billion (50.8%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving \$116.6 billion to be funded with general revenues (mainly taxes). The primary government’s general revenues of \$126.3 billion exceeded net unfunded expenses by \$9.7 billion, resulting in a positive net position for the first time in five years.

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, 2014 and 2013

(amounts in millions)

	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>REVENUES</b>						
Program Revenues:						
Charges for services .....	\$ 22,274	\$ 23,102	\$ 25,284	\$ 28,379	\$ 47,558	\$ 51,481
Operating grants and contributions .....	69,861	60,944	1,491	1,323	71,352	62,267
Capital grants and contributions .....	1,516	1,669	81	142	1,597	1,811
General Revenues:						
Taxes .....	125,812	118,645	—	—	125,812	118,645
Investment and interest .....	81	57	—	—	81	57
Miscellaneous .....	488	552	—	—	488	552
<b>Total revenues .....</b>	<b>220,032</b>	<b>204,969</b>	<b>26,856</b>	<b>29,844</b>	<b>246,888</b>	<b>234,813</b>
<b>EXPENSES</b>						
Program Expenses:						
General government .....	14,292	15,390	—	—	14,292	15,390
Education .....	54,720	50,586	—	—	54,720	50,586
Health and human services .....	105,037	94,070	—	—	105,037	94,070
Resources .....	5,855	5,671	—	—	5,855	5,671
State and consumer services .....	590	1,475	—	—	590	1,475
Business and transportation .....	13,427	12,836	—	—	13,427	12,836
Correctional programs .....	11,235	10,082	—	—	11,235	10,082
Interest on long-term debt .....	4,699	4,350	—	—	4,699	4,350
Electric Power .....	—	—	835	488	835	488
Water Resources .....	—	—	983	1,127	983	1,127
Public Buildings Construction .....	—	—	—	410	—	410
State Lottery .....	—	—	5,079	4,499	5,079	4,499
Unemployment Programs .....	—	—	13,673	17,599	13,673	17,599
California State University .....	—	—	6,545	6,197	6,545	6,197
Other enterprise programs .....	—	—	143	140	143	140
<b>Total expenses .....</b>	<b>209,855</b>	<b>194,460</b>	<b>27,258</b>	<b>30,460</b>	<b>237,113</b>	<b>224,920</b>
<b>Excess (deficiency) before transfers ....</b>	<b>10,177</b>	<b>10,509</b>	<b>(402)</b>	<b>(616)</b>	<b>9,775</b>	<b>9,893</b>
Transfers .....	(2,296)	(1,998)	2,296	1,998	—	—
Special item .....	(55)	—	(27)	—	(82)	—
Change in net position .....	7,826	8,511	1,867	1,382	9,693	9,893
<b>Net position, beginning (restated) .....</b>	<b>(5,822)</b>	<b>(16,648)</b>	<b>3,450</b>	<b>2,684</b>	<b>(2,372)</b>	<b>(13,964)</b>
<b>Net position (deficits), ending .....</b>	<b>\$ 2,004</b>	<b>\$ (8,137)</b>	<b>\$ 5,317</b>	<b>\$ 4,066</b>	<b>\$ 7,321</b>	<b>\$ (4,071)</b>

**Governmental Activities**

Governmental activities' expenses, transfers, and a special item totaled \$212.2 billion. Program revenues totaling \$93.7 billion, including \$71.4 billion received in federal grants, funded 44.1% of expenses and transfers, leaving \$118.5 billion to be funded with general revenues (mainly taxes). General revenues for governmental activities totaled \$126.3 billion, and the governmental activities' total restated net deficit

position of \$5.8 billion at the end of fiscal year 2012-13 improved to a positive net position of \$2.0 billion for the year ended June 30, 2014, an increase of \$7.8 billion (134.4%).

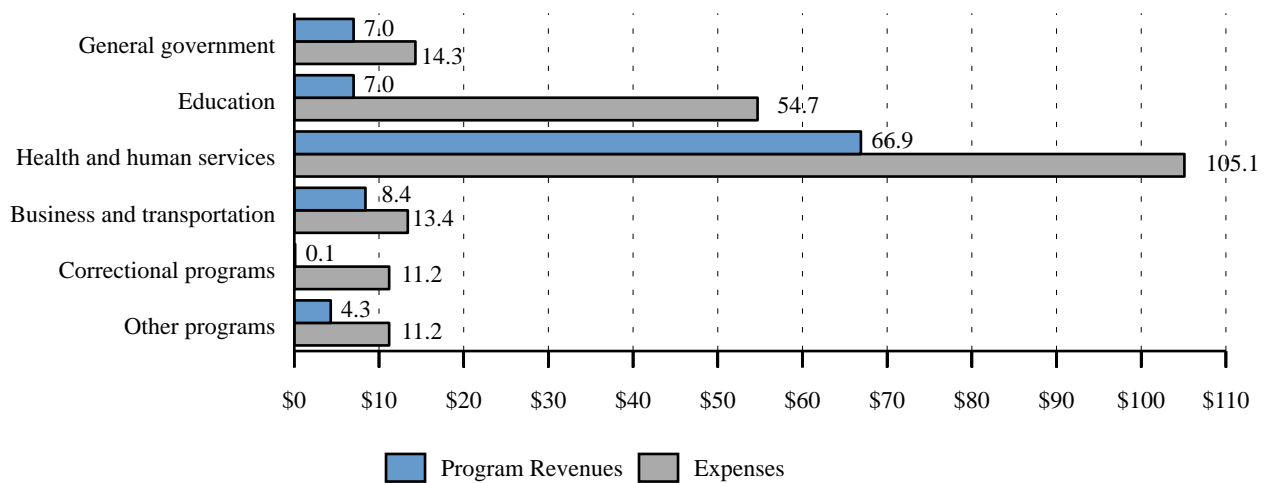
Chart 1 presents a comparison of governmental activities' expenses by program, with related revenues.

**Chart 1**

**Expenses and Program Revenues – Governmental Activities**

Year ended June 30, 2014

(amounts in billions)



For the year ended June 30, 2014, total state tax revenues collected for governmental activities increased by \$6.6 billion (5.8%) over the prior year. Personal income taxes increased by \$1.3 billion (1.9%) as a result of California's stronger job market; the continued effect of Proposition 30, which increased personal income tax on earnings above \$250,000; increased capital gains taxes from a strong stock market; and increasing home prices. Sales and use tax revenue increased by \$2.6 billion (7.8%) due to the 0.25% increase in the State's sales tax effective on January 1, 2013, and increased consumer spending caused by increased consumer confidence in the improving economy and a reduction in the unemployment rate. Corporate taxes increased by \$1.8 billion (24.9%) due to the State's ongoing economic recovery as well as the passage of Proposition 39, which required multistate corporations to calculate their California income tax liability on the percentage of their sales in California.

Overall expenses for governmental activities increased by \$15.4 billion (7.9%) over the prior year. The largest increase of expenditures, \$11.0 billion (11.7%), occurred in health and human services programs, the majority of which is attributable to the Department of Health Care Services, which administers the State's Medi-Cal program. The growth in spending for health and humans services was due to an increased Medi-Cal caseload, the increased utilization of health care services, the rising costs of those services, and the added costs associated with implementing the Patient Protection and Affordable Care Act—also known as federal health care reform. State and consumer services expenses decreased by \$886 million (60.0%) largely due to the shift of certain state and consumer services expenses to general government as a result of the Governor's Reorganization Plan No. 2.

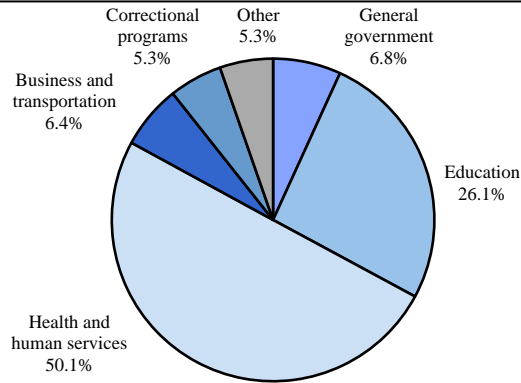
Charts 2 and 3 present the percentage of total expenses for each governmental activities program and the percentage of total revenues by source.

**Chart 2**

**Expenses by Program**

Year ended June 30, 2014

(as a percent)

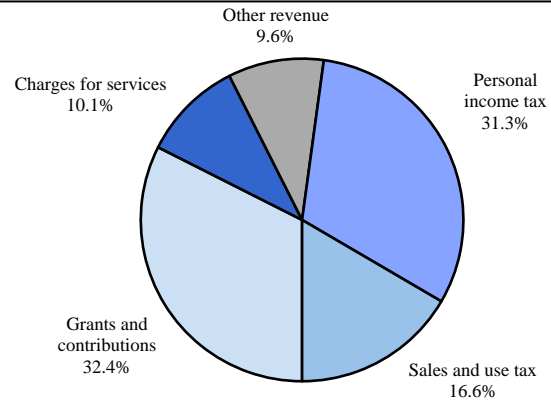


**Chart 3**

**Revenues by Source**

Year ended June 30, 2014

(as a percent)



**Business-type Activities**

Business-type activities' expenses totaled \$27.3 billion. Program revenues of \$26.9 billion, primarily generated from charges for services, and \$2.3 billion in transfers were sufficient to cover these expenses. Consequently, the business-type activities' total net position increased by \$1.9 billion, or 54.1%, during the year ended June 30, 2014.

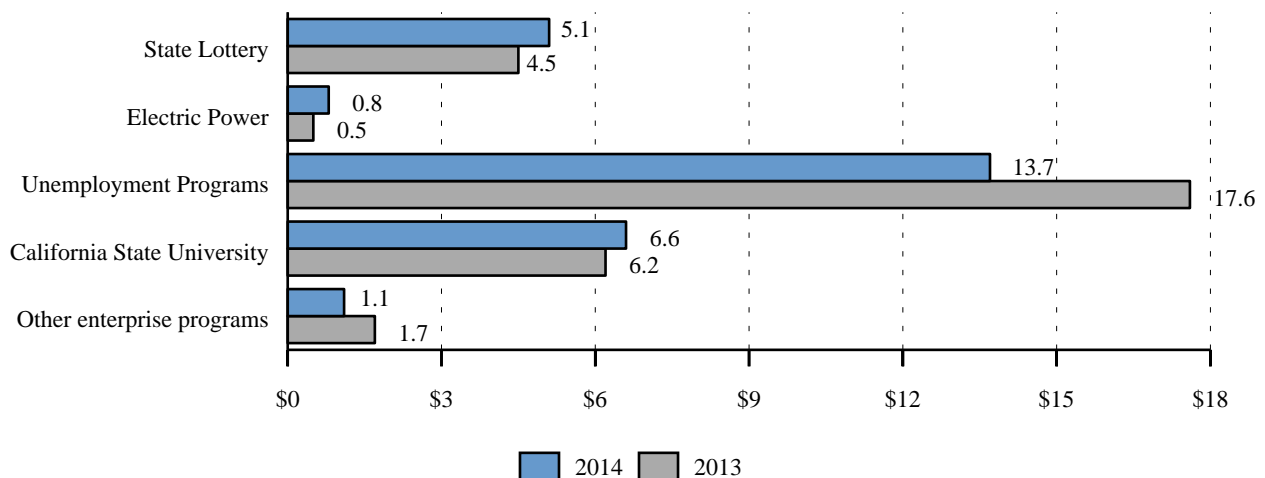
Chart 4 presents a two-year comparison of the expenses of the State's business-type activities.

**Chart 4**

**Expenses – Business-type Activities – Two-year Comparison**

Year ended June 30, 2014 and 2013

(amounts in billions)





## Fund Financial Analysis

The State's governmental funds had an \$8.1 billion increase in fund balance over the prior year's restated ending fund balance. Proprietary funds' net position increased by \$1.9 billion for the fiscal year 2013-14, of which \$1.5 billion was in the Unemployment Programs Fund, reducing its net position deficit to \$2.7 billion.

### Governmental Funds

The governmental funds' Balance Sheet reported \$74.3 billion in assets, \$54.6 billion in liabilities and deferred inflows of resources, and \$19.8 billion in fund balance as of June 30, 2014. Total assets of governmental funds increased by 15.8%, while total liabilities increased by 5.1%, resulting in a total fund balance increase of \$8.1 billion (69.2%) over the prior fiscal year.

Within the governmental funds' total fund balance, \$156 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, \$24.7 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, \$3.0 billion is classified as committed for specific purposes and \$19 million is classified as assigned for specific purposes. The unassigned balance of the governmental funds is a negative \$8.1 billion.

The Statement of Revenues, Expenditures and Changes in Fund Balances of the governmental funds reported \$219.9 billion in revenues, \$218.3 billion in expenditures, and a net \$6.6 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2014, was \$19.8 billion, an \$8.1 billion increase over the prior year's restated ending fund balance of \$11.7 billion. The primary reason for the increase in fund balance was an increase in the year-end balances of cash reserves and receivables, primarily from tax revenue and federal grants.

Personal income taxes, which account for 54.6% of tax revenues and 31.3% of total governmental fund revenues, increased by \$1.3 billion over the prior fiscal year. Sales and use taxes, which account for 28.9% of tax revenues and 16.6% of total governmental fund revenues, increased by \$2.5 billion over the prior fiscal year. Corporation taxes, which account for 7.3% of tax revenues and 4.2% of total governmental fund revenues, increased by \$2.0 billion over the prior fiscal year. Governmental fund expenditures increased by \$16.2 billion over the prior fiscal year, primarily for education and health and human services. General obligation bonds and commercial paper of \$5.1 billion were issued during the 2013-14 fiscal year, an increase of \$1.0 billion over 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 \$7.4 billion. The Federal Fund, the Transportation Fund, and the Environmental and Natural Resources Fund ended the fiscal year with fund balances of \$212 million, \$7.5 billion, and \$7.6 billion, respectively. The nonmajor governmental funds ended the fiscal year with a total fund balance of \$11.9 billion.

*General Fund:* As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of \$19.4 billion; liabilities and deferred inflows of resources of \$26.9 billion; and nonspendable, restricted, and committed fund balances of \$129 million, \$394 million, and \$125 million, respectively, leaving the General Fund with a negative unassigned fund balance of \$8.1 billion. Total assets of the General Fund increased by \$3.8 billion (24.1%) over the prior fiscal year, while the total liabilities and deferred inflows of resources of the General Fund decreased by \$3.0 billion (10.2%). Total net fund deficit balance decreased by \$7.6 billion (50.6%).

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances, the General Fund had an excess of revenues over expenditures of \$8.9 billion (\$104.2 billion in revenues and \$95.3 billion in expenditures). Approximately 95.1% of General Fund revenue (\$99.1 billion) is derived from the State's largest three taxes—personal income taxes (\$67.6 billion), sales and use taxes (\$22.3 billion), and corporation taxes (\$9.2 billion). As a result of fund classifications made to comply with governmental accounting standards, a total of \$244 million in revenue, essentially all from unemployment programs, is included in the General Fund. These revenues are not considered General Fund revenues for any budgetary purposes or for the State's Budgetary/Legal Basis Annual Report.

During the 2013-14 fiscal year, total General Fund revenue increased by \$4.8 billion (4.8%). The increase is a result of increases in corporation taxes of \$2.0 billion (27.3%), sales and use taxes of \$1.9 billion (9.1%), and personal income taxes of \$1.4 billion (2.1%).

General Fund expenditures increased by \$5.2 billion (5.8%). The largest increases were in education and health and human services expenditures, which were up \$3.9 billion and \$961 million, respectively. The General Fund's deficit for the year ended June 30, 2014, was \$7.4 billion, a decrease of \$7.6 billion from the prior year's restated ending fund deficit of \$15.1 billion.

*Federal Fund:* This fund reports federal grant revenues and related expenditures to support the grant programs. The largest of these programs is for health and human services, which accounted for \$58.1 billion (82.4%) of the total \$70.5 billion in Federal 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 \$6.9 billion (9.8%). The Federal Fund's revenue increased by \$8.8 billion, which was approximately the same amount of the increase in combined expenditures and transfers, resulting in only a \$14 million fund balance increase from the prior year's ending fund balance of \$198 million.

*Transportation Fund:* This fund accounts for fuel taxes, bond proceeds, and other revenues used primarily for highway and passenger rail maintenance and construction. The Transportation Fund's revenues increased by 7.0% and expenditures increased by 10.4%. Other financing sources provided net receipts of \$2.2 billion. The Transportation Fund ended the fiscal year with a \$7.5 billion fund balance, an increase of \$236 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 \$640 million. The Environmental and Natural Resources Fund ended the fiscal year with a \$7.6 billion fund balance, a decrease of \$187 million (2.4%) from the prior year.

## **Proprietary Funds**

During the fiscal year, the Public Buildings Construction Fund was reclassified from an enterprise fund to an internal service fund, causing restated beginning net positions and large differences in lease receivables, revenue bonds payable, and related revenues and expenses for both fund types.

*Enterprise Funds:* The total net position of the enterprise funds at June 30, 2014, was \$5.3 billion—\$1.9 billion greater than the prior year's restated ending net position of \$3.4 billion. The Unemployment Programs Fund had a decrease in its deficit net position of \$1.5 billion, while the California State University Fund and nonmajor enterprise funds increased their net positions by \$264 million and \$111 million, respectively.

As shown on the Statement of Net Position of proprietary funds, total assets and deferred outflows of resources of the enterprise funds was \$33.7 billion as of June 30, 2014. Of this amount, current assets totaled \$11.2 billion, noncurrent assets totaled \$22.3 billion, and deferred outflows of resources totaled \$242 million. The total liabilities and deferred inflows of resources of the enterprise funds was \$28.4 billion. The largest liabilities of the enterprise funds are \$13.0 billion of revenue bonds payable and \$7.6 billion of noncurrent loans payable. During the 2013-14 fiscal year, the State reduced the balance of the loans from the U.S Department of Labor that covered prior year deficits in the Unemployment Programs Fund, by \$952 million, leaving a balance of \$7.6 billion as of June 30, 2014.

Total net position consisted of four segments: net investment in capital assets of \$2.1 billion, a nonexpendable restricted net position of \$16 million, a restricted expendable net position of \$4.9 billion, and an unrestricted net deficit of \$1.7 billion.

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Position of proprietary funds, the enterprise funds ended the year with operating revenues of \$24.2 billion, operating expenses of \$24.7 billion, and net revenues from other transactions of \$49 million. The largest sources of operating revenue were unemployment and disability insurance receipts of \$15.2 billion in the Unemployment Programs Fund, and lottery ticket sales of \$5.0 billion collected by the State Lottery Fund. The unemployment and disability insurance receipts in the Unemployment Programs Fund decreased by \$3.4 billion from \$18.6 billion in the prior fiscal year. These receipts came primarily from the federal government unemployment account to pay unemployment and disability benefits. The largest operating expenses were distributions of \$13.4 billion to beneficiaries by the Unemployment Programs Fund, and personal services of \$4.0 billion by the California State University Fund.

*Internal Service Funds:* The total net position of the internal service funds was \$547 million as of June 30, 2014. The net position consists of three segments: net investment in capital assets of \$245 million, restricted net position of \$287 million, and unrestricted net position of \$15 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 \$6.1 billion. The pension and other employee benefit trust funds ended the fiscal year with net position of \$510.2 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net position of \$21.1 billion. Agency funds act as clearing accounts and thus do not have a net position.

For the year ended June 30, 2014, the fiduciary funds' combined net position was \$537.5 billion, a \$67.9 billion increase over 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.

## **General Fund Budget Highlights**

The original General Fund budget of \$95.3 billion was increased by \$4.1 billion. This increase is mainly comprised of funding augmentations for health and human services, education, and correctional programs. The increase in health and human services program funding is primarily due to the implementation of the Patient Protection and Affordable Care Act, as well as caseload increases and augmentations for program contingencies. The Proposition 98 minimum guarantee increased education funding as the result of increased General Fund revenue in the 2013-14 fiscal year. The augmentation of correctional programs was authorized by the California Community Corrections Performance Incentive Act for the purpose of providing

probation-failure-reduction incentive payments and high-performance grants. During fiscal year 2013-14, the General Fund actual budgetary basis expenditures were \$98.0 billion, or \$1.4 billion less than the final budgeted amount of \$99.4 billion.

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, 2014

(amounts in millions)

	Original	Final	Increase
<b>Budgeted amounts</b>			
State and consumer services .....	\$ 14	\$ 14	\$ —
Business and transportation .....	91	91	—
Resources .....	1,109	1,263	154
Health and human services .....	27,518	29,390	1,872
Correctional programs .....	8,610	9,349	739
Education .....	48,409	49,570	1,161
General government:			
Tax relief .....	422	425	3
Debt service .....	4,801	4,801	—
Other general government .....	4,328	4,478	150
<b>Total .....</b>	<b>\$ 95,302</b>	<b>\$ 99,381</b>	<b>\$ 4,079</b>

## 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, 2014, amounted to \$125.1 billion (net of accumulated depreciation/amortization). The State's capital assets include 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. Infrastructure assets are items that normally are immovable, such as roads and bridges, and can be preserved for a greater number of years than can most capital assets.

As of June 30, 2014, the State's capital assets increased \$6.5 billion over the prior fiscal year. The majority of this increase occurred in buildings and other depreciable property, and construction in progress. Included in the capital assets increase is a \$2.2 billion beginning balance restatement, primarily for understated state highway infrastructure construction in progress.

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

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

**Table 4**

**Capital Assets**

June 30, 2014

(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land .....	\$ 18,258	\$ 222	\$ 18,480
State highway infrastructure .....	65,269	—	65,269
Collections – nondepreciable .....	23	7	30
Buildings and other depreciable property .....	27,554	11,738	39,292
Intangible assets – amortizable .....	1,091	336	1,427
Less: accumulated depreciation/amortization .....	(12,150)	(4,581)	(16,731)
Construction in progress .....	14,858	764	15,622
Intangible assets – nonamortizable .....	1,466	249	1,715
<b>Total .....</b>	<b>\$ 116,369</b>	<b>\$ 8,735</b>	<b>\$ 125,104</b>

### Modified Approach for Infrastructure Assets

The State has elected to use the modified approach for capitalizing infrastructure assets of the state highway system (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 2013-14 fiscal year, the actual amount spent on preservation was 29.6% of the estimated budgeted amount needed to maintain the infrastructure assets at the established condition levels. Although the amount spent fell short of the budgeted amount, the assessed condition of the State's bridges and roadways is better than the established condition baselines. The State is responsible for maintaining 49,718 lane miles and 13,120 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

The State's largest long-term obligations are its bonded debt. At June 30, 2014, the primary government had total bonded debt outstanding of \$115.9 billion. Of this amount, \$84.0 billion (72.5%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the \$84.0 billion of general obligation bonds is \$4.6 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 \$4.0 billion and the long-term portion is \$80.0 billion. The remaining \$31.9 billion (27.5%) 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 \$30.3 billion. During the fiscal year, the State issued \$5.9 billion in new general obligation bonds for transportation projects, housing

and emergency shelters, stem cell research, children's hospitals, various water and flood control projects, and to refund previously outstanding general obligation bonds and commercial paper.

Table 5 presents a summary of all the primary government's long-term obligations for governmental and business-type activities.

**Table 5**

**Long-term Obligations**

June 30, 2014

(amounts in millions)

	Governmental Activities	Business-type Activities	Total
<b>Government-wide noncurrent liabilities</b>			
General obligation bonds .....	\$ 79,287	\$ 617	\$ 79,904
Revenue bonds payable.....	18,270	12,070	30,340
Net other postemployment benefits obligation .....	18,617	628	19,245
Mandated cost claims payable .....	7,715	—	7,715
Loans payable .....	—	7,633	7,633
Compensated absences payable .....	3,751	183	3,934
Workers compensation benefits payable .....	3,291	3	3,294
Net pension obligation .....	3,238	—	3,238
Capital lease obligations .....	200	1,180	1,380
Certificates of participation and commercial paper .....	589	51	640
Other noncurrent liabilities .....	2,563	1,141	3,704
<b>Total noncurrent liabilities .....</b>	<b>137,521</b>	<b>23,506</b>	<b>161,027</b>
Current portion of long-term obligations .....	5,807	1,931	7,738
<b>Total long-term obligations .....</b>	<b>\$ 143,328</b>	<b>\$ 25,437</b>	<b>\$ 168,765</b>

During the year ended June 30, 2014, the primary government's total long-term obligations increased by \$2.9 billion over the prior year's restated balance. The prior year balance was restated primarily for the elimination of the governmental activities' capital lease obligation for lease-purchase agreements between the State Public Works Board, and governmental funds when the Public Buildings Construction Fund was reclassified from an enterprise fund (business-type activity) to an internal service fund (governmental activity). Net other postemployment benefits obligation increased the most (\$3.2 billion) during the fiscal year, but other notable increases occurred in state-mandated cost claims payable (\$1.1 billion) and general obligation bonds payable (\$717 million). The net other postemployment benefits obligation increased because the State does not fully fund the annual cost of these benefits. The largest decreases were in revenue bonds payable (\$1.4 billion) and loans payable to the U.S. Department of Labor for prior year shortfalls in the unemployment program (\$952 million).

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

In August 2013, Fitch raised the State's general obligation rating to "A" from "A-", citing the State's institutional changes to fiscal management and its ongoing economic and revenue recovery. In June 2014, Moody's raised the State's general obligation rating to "Aa3" from "A1", citing the State's rapidly improving financial position, high but declining debt metrics, adjusted net pension liability ratios that are close to the state median, strong liquidity, and robust employment growth. During the 2013-14 fiscal year, the rating from Standard and Poor's remained unchanged at "A".



## **Economic Condition and Future Budgets**

### **The Economy for the Year Ending June 30, 2014**

The U.S. economy completed its fifth year of recovery as California ended its fiscal year on June 30, 2014. National economic growth was somewhat erratic, with a difficult winter quarter followed by a solid spring rebound. The U.S. real gross domestic product (GDP) had a moderate 2.5% increase over the 12 months spanning the State's fiscal year.

California's income growth outperformed the nation in the 2013-14 fiscal year. The State's total personal income increased 3.5% during the fiscal year versus the 2.6% increase the nation experienced. As personal income grew, consumer spending increased, as substantiated by the 6.6% increase in auto registrations, for a total of 1.7 million registered vehicles for the 12 months ended June 30, 2014.

The State's real estate market showed signs of stabilizing at the end of the fiscal year compared to the market a year earlier, in which it was common for multiple offers to be made on a property and for it to be sold for more than its list price. As of June 2014, prices were significantly higher, 6.6% over the prior year, but sales were down by about 5%. Homebuilding in California picked up substantially, as permits issued during the fiscal year increased approximately 12%, to more than 82,000 units. Similarly, nonresidential building rebounded during the fiscal year; the value of nonresidential permits increased 44% to \$23 billion. Retail stores, hotels, amusement parks, offices, and renovations contributed to the large increase.

California's job market both illustrated the State's recovery and contributed to it during the fiscal year. In June 2014, nonfarm employment surpassed its pre-recession high. With a 12-month gain of 347,500 jobs, employment was 2.3% higher than in June 2013. Job growth was widespread, with notable increases in construction, trade, leisure and hospitality, health care, and business and public services. Financial services, nondurable goods manufacturing, and the federal government were the only areas that experienced job losses. The improvement in the labor market was demonstrated by the drop in the State's unemployment rate from 9.0% in June 2013 to 7.4% in June 2014.

California ended the 2013-14 fiscal year with impressive economic gains. Consumers benefited from gains in jobs, personal income, home prices, and the stock market. California's economic and financial health was clearly on the mend even though the unemployment rate remained relatively high at the end of the fiscal year.

### **Economic Performance for the 2014-15 Fiscal Year as of January 31, 2015**

California's economy continued to improve during the first several months of fiscal year 2014-15. Job gains, falling unemployment, increases in personal income, higher auto sales, and rising construction in both the residential and nonresidential markets demonstrate the continuing economic recovery.

Employment gains averaged 30,000 jobs per month during the first six months of the fiscal year, and as of December 2014, nonfarm employment increased 2.3% over its June 2014 level. Job increases were spread across a wide array of industries and sectors, and by December 2014, 11 of California's major metropolitan areas (representing 36% of the State's total labor market) had returned to their pre-recession job peaks. California's unemployment rate continued to fall during the first six months of the 2014-15 fiscal year; by December 2014, it had receded to 7.0% from 7.4% in June 2014.

The State began the first quarter of the new fiscal year with a solid gain of 3.9% in total personal income compared with the prior quarter. Job gains, personal income increases, and low interest rates, spurred a 9%



increase in new auto registrations during the first four months of the fiscal year over the same period in the prior fiscal year.

The housing market returned to a more normal and sustainable pace as of December 2014. The stabilizing of home prices in recent months put home prices a moderate 3% above their prior year level as of December 2014. Although December's year-over-year rise in home sales was just 0.6%, it was the first increase in nearly a year and a half.

New construction activity continued to advance. On the housing front, building permits during the first six months of the 2014-15 fiscal year increased 5.7% over the total recorded during the first half of the prior fiscal year. The value of nonresidential permits gained 8.3%, with solid increases in industrial, office, retail, hotel, and building improvements.

California continues to make particular strides in technology, as evidenced by the advances of California businesses in web applications, biotech, mobile devices, alternative energy, and environmental science. During the first few months of the 2014-15 fiscal year, the State attracted \$12.9 billion of venture capital, representing more than half of the national total.

As California moves into the remaining months of the 2014-15 fiscal year, it appears well positioned for further economic gains. Although challenged by an ongoing drought, economic and other instabilities abroad, and continuing budget pressures, the State's economy is clearly making progress on many fronts. The expected further growth in technology, health care, tourism, business and professional services, and construction all promise to deepen and broaden the State's economic expansion.

### **California's 2014-15 Budget**

California's 2014-15 Budget Act was enacted on June 20, 2014. The Budget Act appropriated \$156.3 billion: \$108.0 billion from the General Fund, \$44.3 billion from special funds, and \$4.0 billion from bond funds. The General Fund's budgeted expenditures increased \$7.3 billion (7.2%) over last year's General Fund budget and included a \$1.6 billion supplemental payment to pay off the remaining balance of the State's prior deficit financing bonds, known as Economic Recovery bonds. The General Fund's available resources were projected to be \$105.5 billion, after a projected \$1.6 billion transfer to the Budget Stabilization Account (Rainy Day Fund). General Fund revenue comes predominantly from taxes, with personal income taxes expected to provide 65.6% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) are projected to supply approximately 96.2% of the General Fund's resources in the 2014-15 fiscal year.

The 2014-15 budget continued the Governor's multi-year financial plan for the State of California, and for the third consecutive year, it projected a surplus in the General Fund. The 2014-15 fiscal year is projected to end with \$2.1 billion in total reserves—\$1.6 billion in the Budget Stabilization Account and \$449 million reserved for economic uncertainties. The 2014-15 budget made targeted augmentations in a few key areas while paying down several billion dollars of existing liabilities, including the Economic Recovery bonds mentioned above.

Budget-related legislation was enacted to erase the California State Teachers' Retirement System' (CalSTRS) \$74 billion unfunded liability in 32 years by increasing contributions from the State, school and community college districts, and teachers. The State is responsible for approximately \$20 billion of the unfunded liability. The 2014-15 budget provided \$1.5 billion in state contributions to CalSTRS, of which \$59 million will be used toward reducing the State's share of the unfunded liability.

The 2014-15 budget included an increase of \$2.6 billion over the prior year revised estimate, to \$60.9 billion, for the minimum annual funding guarantee for schools and community colleges (Proposition 98 funding). The budget also provided \$5.2 billion to reduce the Proposition 98 funding deferrals accumulated in prior years, leaving a balance of \$992 million by the end of the 2014-15 fiscal year. However, this balance may be fully eliminated if, in the May 2015 budget revision, the minimum guarantee for fiscal years 2013-14 and 2014-15 is higher than assumed in the 2014-15 budget package.

The spending plan for fiscal year 2014-15 includes General Fund money for health programs of \$19.3 billion, which is an increase of almost \$700 million, or 3.7%, over the 2013-14 funding level. This increase primarily addresses increased Medi-Cal program costs due to the implementation of the Patient Protection and Affordable Care Act, as well as increases in caseload and the need for health care services. It is estimated that approximately 825,000 additional people who were previously eligible for Medi-Cal, but who were unenrolled, will receive benefits during the 2014-15 fiscal year under the current 50-50 state-federal cost sharing arrangement.

General Fund revenues and expenditures tend to peak in different months, and the State typically experiences spending in excess of revenues during the first several months of the fiscal year. During the 2014-15 fiscal year, this gap has been significantly smaller than projected in the 2014-15 budget. As of December 1, 2014, revenues were \$1.3 billion more than forecasted, while total disbursements were \$1.3 billion below estimates. As a result, the General Fund's increase in temporary borrowing was \$2.7 billion less than projected, leaving a balance of \$18.5 billion in short-term borrowing—\$15.7 billion of internal borrowing from other state funds and \$2.8 billion from revenue anticipation notes issued in September 2014.

## **California's 2015-16 Budget**

The Governor released his proposed 2015-16 budget on January 9, 2015; he sees maintaining a balanced budget as an ongoing challenge for the long term, requiring both fiscal restraint and prudence. The budget assumes the continued moderate expansion of the economy, and continues with the Governor's multi-year plan to build reserves and pay down outstanding debt. Proposition 2 was approved by voters in November 2014 and affects the budget for the first time in fiscal year 2015-16. Proposition 2 gives the State an opportunity to avoid budget shortfalls that are driven by ongoing spending commitments based on temporary spikes in revenues from capital gains. Under Proposition 2, spikes in capital gains will instead be used to save money for the next recession and to pay down the State's debts and unfunded liabilities. The budget proposes total reserves of \$3.4 billion by the end of the 2015-16 fiscal year—\$2.8 billion in the Budget Stabilization Account required under Proposition 2 and \$534 million in the General Fund's reserve for economic uncertainties. In addition to the required reserve, Proposition 2 requires an equivalent amount be used to pay down existing debts. During the 2015-16 fiscal year, the Governor proposes to pay down the General Fund's loans from special funds and Proposition 98 obligations by a total of \$1.2 billion.

The 2015-16 Governor's Budget projects that General Fund revenues and transfers will be \$113.4 billion and expenditures will be \$113.3 billion, with an estimated \$1.5 billion year-end balance, which includes the \$534 million reserve. In the proposed budget, the General Fund began fiscal year 2014-15 with a surplus balance of \$5.1 billion; it is projected to begin fiscal year 2015-16 with a surplus of approximately \$1.4 billion. Estimated General Fund revenues and transfers are 4.9% more than the revised 2014-15 estimate of \$108.0 billion, while the 2014-15 expenditures are 1.4% greater than the revised 2014-15 estimate of \$111.7 billion.

Personal income tax is projected to increase by \$3.5 billion (4.9%) over the prior year revised estimate. This represents a major component of the \$5.0 billion General Fund revenue increase. Sales and use taxes are also projected to increase by \$1.7 billion (7.4%) and corporation tax by \$0.6 billion (5.8%). The budget's projected increases in General Fund revenue trigger higher education spending through the Proposition 98 minimum

funding guarantees for both the 2014-15 and 2015-16 fiscal years. The Governor's budget includes \$7.8 billion in Proposition 98 funding increases, with a large portion of new funding (\$5.0 billion) dedicated to implementation of the Local Control Funding Formula (LCFF), a package of workforce education and training initiatives, and various community college augmentations. The Governor's budget package also provides \$2.8 billion to significantly reduce the State's outstanding Proposition 98 obligations (including eliminating all remaining school and community college payment deferrals and reducing the backlog of education mandate claims).

The Governor's budget for fiscal year 2014-15 assumes increased spending for health and human services of \$1.4 billion, or 4.7%, mainly within the Medi-Cal program. The increase will ensure continued implementation of federal health care reform, which will enable millions of Californians to obtain health care coverage. Numerous recent federal actions in the health and human services area have increased State costs or created substantial fiscal uncertainty. Therefore, assumptions made in the 2014-15 budget could ultimately turn out differently and result in either additional costs or budget savings. The 2014-15 proposed budget provides additional funding to resources and environmental protection programs for flood prevention, water projects, drought-related activities, and greenhouse-gas-emissions reduction. The budget also proposes a small one-time allocation to address some of the State's \$66 billion infrastructure deferred maintenance backlog.

According to the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, the Governor's plan is reasonable—dedicating most new ongoing funding to the State's high-priority program needs and most one-time funding to paying off outstanding obligations. The LAO indicates that there is a strong possibility that revenues for the 2014-15 fiscal year will be significantly above the Governor's projections, which will result in even more funding in fiscal year 2014-15 for schools and community colleges under the Proposition 98 minimum funding guarantee, and could result in higher ongoing payments to schools. As further evidence of the improvement in the State's finances in recent years, the Governor's cash flow projections assume that the State will not need to issue a revenue anticipation note (RAN) to meet cash flow needs during 2015-16. If the projections hold, fiscal year 2015-16 would be only the second year since the mid-1980s that the State has not issued a RAN. However, LAO cautions that this level of peak revenue will likely not last, and that the higher current-year revenue and resulting increase in ongoing school spending, present a potential challenge for the State's 2015-16 budget and beyond.

### **Future Changes in Pension Plan Reporting**

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 67, No. 68, and No. 71 amending accounting and financial reporting standards for defined benefit and defined contribution pension plans for employers and pension plan sponsors nationwide. The initial phase of the implementation was completed by the State's pension plan sponsors—the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). Both CalPERS and CalSTRS prepared financial statements for the fiscal year ended June 30, 2014, in conformity with GASB Statement No. 67. The next phase of implementation requires additional actuarial and accounting information to be reported in the State of California's Comprehensive Annual Financial Report (CAFR) for the fiscal year ending June 30, 2015, in conformity with GASB Statements No. 68 and No. 71; this one-year lag is allowable in the new standards. Therefore, the disclosure in Note 24, Pension Trusts and the Schedule of Funding Progress included in the required supplementary information in this year's CAFR is largely the same as the previous years' information, but next year it will be significantly different.

The effect of the new standards' implementation is arguably the largest accounting and financial reporting change to state and local governments nationwide in over a decade. However, the economic and budgetary impact of the change is expected to be minimal. The State will be presenting new accounting information, note disclosures, and required supplementary information as a result of the implementation.

There are four major changes that will occur in the State's CAFR for the fiscal year ending June 30, 2015:

- The State's net pension liability (NPL) will be presented in the government-wide Statement of Net Position. The NPL consists of the fair value of the State's investments in CalPERS' pension plans, less current payables and the total pension liability attributable to the State's workforce for services rendered to the date of valuation. An additional liability will be reported for the State's obligations to CalSTRS' pension plans in accordance with the provisions of the California Education Code.
- The State's pension expense reported in the government-wide Statement of Activities will reflect the change in the pension obligation that occurred during the fiscal year. Pension expense will be comprised of the pensionable service cost of current employees, as adjusted for investment return and amortization of various prior gains and losses, as well as other demographic and plan changes.
- The notes to the financial statements related to pension trusts will be revised to include new required disclosures including information from the pension plans' actuarial valuations and from other sources. In most instances, the information will be from the previous year as recommended by the new standards.
- The required supplementary information related to pension plans will dramatically change. The Schedule of Funding Progress will be discontinued and the information required by the new standards will grow to include sets of ten-year schedules.

The accounting changes needed to implement GASB Statement No. 68 and No. 71 will require the restatement of the beginning net position in the government-wide financial statements as of July 1, 2014. The amount of this restatement is currently being calculated.

The State's timely and successful implementation of GASB's new pension plan standards is the result of an intensive and collaborative effort by officials of the State's pension plan sponsors (CalPERS and CalSTRS), the State Controller's Office, and the California State Auditor's Office.

## **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 through email to the State Controller's Office, Division of Accounting and Reporting at [StateGovReports@sco.ca.gov](mailto:StateGovReports@sco.ca.gov). This report is also available on the State Controller's Office website at [www.sco.ca.gov](http://www.sco.ca.gov).

# Basic Financial Statements



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# **Government-wide Financial Statements**





# Statement of Net Position

**June 30, 2014**

(amounts in thousands)

	Primary Government			Component
	Governmental	Business-type	Total	Units
	Activities	Activities		
ASSETS				
Current assets:				
Cash and pooled investments .....	\$ 26,565,130	\$ 5,433,555	\$ 31,998,685	\$ 2,353,088
Amount on deposit with U.S. Treasury .....	—	25,215	25,215	—
Investments .....	634,223	2,530,307	3,164,530	5,222,524
Restricted assets:				
Cash and pooled investments .....	3,339,603	676,975	4,016,578	128,517
Investments .....	—	—	—	15,929
Due from other governments .....	—	20,182	20,182	—
Net investment in direct financing leases .....	100,829	11,442	112,271	—
Receivables (net) .....	16,404,305	1,970,482	18,374,787	3,787,272
Internal balances .....	(329,500)	329,500	—	—
Due from primary government .....	—	—	—	206,341
Due from other governments .....	16,372,910	285,990	16,658,900	97,342
Prepaid items .....	124,378	48,396	172,774	1,276
Inventories .....	76,700	15,813	92,513	194,615
Recoverable power costs (net) .....	—	156,000	156,000	—
Other current assets .....	98,740	5,304	104,044	255,168
Total current assets .....	63,387,318	11,509,161	74,896,479	12,262,072
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments .....	402,394	711,814	1,114,208	26,725
Investments .....	—	372,388	372,388	14,286
Loans receivable .....	—	305,278	305,278	—
Investments .....	—	1,178,561	1,178,561	27,930,558
Net investment in direct financing leases .....	851,240	358,915	1,210,155	—
Receivables (net) .....	2,058,389	286,011	2,344,400	2,741,342
Loans receivable .....	4,076,416	3,879,070	7,955,486	4,067,009
Recoverable power costs (net) .....	—	4,490,000	4,490,000	—
Long-term prepaid charges .....	21,885	1,230,632	1,252,517	—
Capital assets:				
Land .....	18,258,395	222,138	18,480,533	1,002,521
State highway infrastructure .....	65,268,686	—	65,268,686	—
Collections – nondepreciable .....	22,630	7,711	30,341	390,678
Buildings and other depreciable property .....	27,553,863	11,738,198	39,292,061	43,499,890
Intangible assets – amortizable .....	1,090,970	336,051	1,427,021	835,971
Less: accumulated depreciation/amortization .....	(12,150,010)	(4,581,349)	(16,731,359)	(20,542,756)
Construction in progress .....	14,857,774	764,065	15,621,839	3,661,522
Intangible assets – nonamortizable .....	1,466,407	248,601	1,715,008	5,082
Other noncurrent assets .....	—	23,173	23,173	353,936
Total noncurrent assets .....	123,779,039	21,571,257	145,350,296	63,986,764
Total assets .....	187,166,357	33,080,418	220,246,775	76,248,836
DEFERRED OUTFLOWS OF RESOURCES .....	986,477	242,167	1,228,644	3,737,238
Total assets and deferred outflows				
of resources .....	\$ 188,152,834	\$ 33,322,585	\$ 221,475,419	\$ 79,986,074

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
LIABILITIES				
Current liabilities:				
Accounts payable .....	\$ 25,731,972	\$ 313,160	\$ 26,045,132	\$ 1,838,598
Due to component units .....	206,341	—	206,341	—
Due to other governments .....	7,111,861	129,160	7,241,021	54,967
Revenues received in advance .....	1,395,296	322,669	1,717,965	1,127,716
Tax overpayments .....	4,872,567	—	4,872,567	—
Deposits .....	396,868	—	396,868	790,051
Contracts and notes payable .....	615	—	615	16,326
Unclaimed property liability .....	730,564	—	730,564	—
Interest payable .....	1,292,513	72,632	1,365,145	60,934
Securities lending obligations .....	—	—	—	1,269,083
Benefits payable .....	—	482,396	482,396	—
Current portion of long-term obligations .....	5,807,107	1,930,899	7,738,006	3,805,538
Other current liabilities .....	910,628	424,932	1,335,560	1,821,788
Total current liabilities .....	48,456,332	3,675,848	52,132,180	10,785,001
Noncurrent liabilities:				
Loans payable .....	—	7,633,391	7,633,391	—
Lottery prizes and annuities .....	—	683,180	683,180	—
Compensated absences payable .....	3,750,543	182,859	3,933,402	275,284
Workers compensation benefits payable .....	3,290,898	2,538	3,293,436	321,338
Certificates of participation, commercial paper, and other borrowings .....	589,575	51,106	640,681	20,255
Capital lease obligations .....	200,192	1,180,232	1,380,424	448,648
General obligation bonds payable .....	79,287,287	617,317	79,904,604	—
Revenue bonds payable .....	18,270,478	12,069,907	30,340,385	19,187,901
Mandated cost claims payable .....	7,715,179	—	7,715,179	—
Net other postemployment benefits obligation .....	18,616,859	628,422	19,245,281	8,580,247
Net pension obligation .....	3,237,785	—	3,237,785	7,725,075
Revenues received in advance .....	—	11,460	11,460	—
Other noncurrent liabilities .....	2,562,633	446,048	3,008,681	1,924,267
Total noncurrent liabilities .....	137,521,429	23,506,460	161,027,889	38,483,015
Total liabilities .....	185,977,761	27,182,308	213,160,069	49,268,016
DEFERRED INFLOWS OF RESOURCES .....	170,802	822,886	993,688	7,110,123
Total liabilities and deferred inflows of resources .....	\$ 186,148,563	\$ 28,005,194	\$ 214,153,757	\$ 56,378,139

(continued)

## Statement of Net Position (continued)

June 30, 2014

(amounts in thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
<b>NET POSITION</b>				
Net investment in capital assets .....	\$ 94,001,659	\$ 2,065,550	\$ 96,067,209	\$ 12,682,963
Restricted:				
Nonexpendable – endowments .....	—	16,219	16,219	5,289,548
Expendable:				
Endowments and gifts .....	—	—	—	9,912,926
Business and transportation .....	10,350,504	6,683	10,357,187	—
Resources .....	4,946,088	569,826	5,515,914	—
Health and human services .....	3,762,680	146,192	3,908,872	—
Education .....	1,141,458	79,018	1,220,476	1,708,757
General government .....	3,946,835	251,141	4,197,976	—
Unemployment programs .....	—	3,800,470	3,800,470	—
State and consumer services .....	801,248	32,133	833,381	—
Correctional programs .....	1,927	11,851	13,778	—
Indenture .....	—	—	—	491,187
Statute .....	—	—	—	1,268,261
Other purposes .....	—	—	—	25,769
Total expendable .....	24,950,740	4,897,314	29,848,054	13,406,900
Unrestricted .....	(116,948,128)	(1,661,692)	(118,609,820)	(7,771,476)
<b>Total net position .....</b>	<b>2,004,271</b>	<b>5,317,391</b>	<b>7,321,662</b>	<b>23,607,935</b>
<b>Total liabilities, deferred inflows of resources, and net position .....</b>	<b>\$ 188,152,834</b>	<b>\$ 33,322,585</b>	<b>\$ 221,475,419</b>	<b>\$ 79,986,074</b>
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# Statement of Activities

Year Ended June 30, 2014

(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary government</b>				
Governmental activities:				
General government .....	\$ 14,292,179	\$ 5,994,608	\$ 1,011,594	\$ —
Education .....	54,719,677	67,165	6,943,619	—
Health and human services .....	105,037,102	7,961,897	58,943,872	—
Resources .....	5,854,685	3,403,524	261,832	—
State and consumer services .....	589,715	586,055	5,358	—
Business and transportation .....	13,427,229	4,247,258	2,606,718	1,515,890
Correctional programs .....	11,234,705	13,645	88,137	—
Interest on long-term debt .....	4,699,265	—	—	—
Total governmental activities .....	209,854,557	22,274,152	69,861,130	1,515,890
Business-type activities:				
Electric Power .....	835,000	835,000	—	—
Water Resources .....	983,048	983,048	—	—
State Lottery .....	5,078,935	5,077,976	—	—
Unemployment Programs .....	13,673,403	15,167,258	—	—
California State University .....	6,544,936	3,014,030	1,491,559	—
High Technology Education .....	847	424	—	—
State Water Pollution Control Revolving .....	5,072	62,985	—	80,903
Housing Loan .....	57,206	65,247	—	—
Other enterprise programs .....	79,641	77,671	—	—
Total business-type activities .....	27,258,088	25,283,639	1,491,559	80,903
<b>Total primary government .....</b>	<b>\$ 237,112,645</b>	<b>\$ 47,557,791</b>	<b>\$ 71,352,689</b>	<b>\$ 1,596,793</b>
<b>Component Units</b>				
University of California .....	28,714,112	16,945,088	8,051,387	473,464
California Housing Finance Agency .....	235,164	38,783	53,462	—
Nonmajor component units .....	2,017,379	1,069,909	564,519	9,147
<b>Total component units .....</b>	<b>\$ 30,966,655</b>	<b>\$ 18,053,780</b>	<b>\$ 8,669,368</b>	<b>\$ 482,611</b>
General revenues:				
Personal income taxes .....				
Sales and use taxes .....				
Corporation taxes .....				
Motor vehicle excise tax .....				
Insurance taxes .....				
Other taxes .....				
Investment and interest .....				
Escheat .....				
Other .....				
Transfers .....				
Special item - Loss on early extinguishment of debt .....				
<b>Total general revenues and transfers .....</b>				
Change in net position .....				
<b>Net position (deficit) - beginning, restated .....</b>				
<b>Net position - ending .....</b>				

Net (Expenses) Revenues and Changes in Net Position			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
\$ (7,285,977)		\$ (7,285,977)	
(47,708,893)		(47,708,893)	
(38,131,333)		(38,131,333)	
(2,189,329)		(2,189,329)	
1,698		1,698	
(5,057,363)		(5,057,363)	
(11,132,923)		(11,132,923)	
(4,699,265)		(4,699,265)	
<u>(116,203,385)</u>		<u>(116,203,385)</u>	
	\$ —	—	
	—	—	
	(959)	(959)	
	1,493,855	1,493,855	
	(2,039,347)	(2,039,347)	
	(423)	(423)	
	138,816	138,816	
	8,041	8,041	
	<u>(1,970)</u>	<u>(1,970)</u>	
	(401,987)	(401,987)	
<u>\$ (116,203,385)</u>	<u>\$ (401,987)</u>	<u>\$ (116,605,372)</u>	
			\$ (3,244,173)
			(142,919)
			<u>(373,804)</u>
			<u>\$ (3,760,896)</u>
\$ 68,793,292	\$ —	\$ 68,793,292	\$ —
36,477,724	—	36,477,724	—
9,102,128	—	9,102,128	—
5,777,167	—	5,777,167	—
3,359,043	—	3,359,043	—
2,302,231	—	2,302,231	—
80,969	—	80,969	3,397,201
487,937	—	487,937	—
—	—	—	2,959,253
(2,296,010)	2,296,010	—	—
(54,537)	(26,913)	(81,450)	—
<u>124,029,944</u>	<u>2,269,097</u>	<u>126,299,041</u>	<u>6,356,454</u>
7,826,559	1,867,110	9,693,669	2,595,558
<u>(5,822,288)</u>	<u>3,450,281</u>	<u>(2,372,007)</u>	<u>21,012,377</u>
<u>\$ 2,004,271</u>	<u>\$ 5,317,391</u>	<u>\$ 7,321,662</u>	<u>\$ 23,607,935</u>

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# Fund Financial Statements



# Balance Sheet

## Governmental Funds

**June 30, 2014**

(amounts in thousands)

	<b>General</b>	<b>Federal</b>
<b>ASSETS</b>		
Cash and pooled investments .....	\$ 4,246,074	\$ 458,076
Investments .....	—	—
Receivables (net) .....	13,165,951	12,520
Due from other funds .....	1,510,895	—
Due from other governments .....	305,388	15,569,689
Interfund receivables .....	49,234	—
Loans receivable .....	126,121	201,804
Other assets .....	11,816	—
<b>Total assets.....</b>	<b>\$ 19,415,479</b>	<b>\$ 16,242,089</b>
<b>LIABILITIES</b>		
Accounts payable .....	\$ 1,358,333	\$ 808,321
Due to other funds .....	9,273,689	12,837,772
Due to component units .....	206,341	—
Due to other governments .....	1,501,160	2,250,533
Interfund payables .....	6,123,537	—
Revenues received in advance .....	718,477	101,103
Tax overpayments .....	4,872,567	—
Deposits .....	1,683	—
Interest payable .....	—	2,583
Unclaimed property liability .....	730,564	—
General obligation bonds payable .....	—	—
Other liabilities .....	573,453	18,136
<b>Total liabilities .....</b>	<b>25,359,804</b>	<b>16,018,448</b>
<b>DEFERRED INFLOWS OF RESOURCES .....</b>	<b>1,500,271</b>	<b>12,067</b>
<b>Total liabilities and deferred inflows of resources .....</b>	<b>26,860,075</b>	<b>16,030,515</b>
<b>FUND BALANCES</b>		
Nonspendable .....	128,609	—
Restricted .....	394,246	211,574
Committed .....	125,120	—
Assigned .....	—	—
Unassigned .....	(8,092,571)	—
<b>Total fund balances (deficit) .....</b>	<b>(7,444,596)</b>	<b>211,574</b>
<b>Total liabilities, deferred inflows of resources, and fund balances .....</b>	<b>\$ 19,415,479</b>	<b>\$ 16,242,089</b>

<u>Transportation</u>	<u>Environmental and Natural Resources</u>	<u>Nonmajor Governmental</u>	<u>Total</u>
\$ 3,567,889	\$ 5,709,974	\$ 11,588,042	\$ 25,570,055
—	—	634,223	634,223
1,129,154	523,853	3,456,906	18,288,384
970,675	48,240	1,206,195	3,736,005
4,647	60,380	411,764	16,351,868
3,362,281	829,227	1,332,720	5,573,462
—	1,113,482	2,635,009	4,076,416
56,443	—	30,481	98,740
<u>\$ 9,091,089</u>	<u>\$ 8,285,156</u>	<u>\$ 21,295,340</u>	<u>\$ 74,329,153</u>
\$ 421,430	\$ 358,736	\$ 934,782	\$ 3,881,602
120,638	47,238	2,765,819	25,045,156
—	—	—	206,341
359,446	30,013	3,514,917	7,656,069
2,316	25,000	8,584	6,159,437
19,810	147,753	93,131	1,080,274
—	—	—	4,872,567
2,243	349	392,164	396,439
—	—	113,669	116,252
—	—	—	730,564
—	—	1,164,630	1,164,630
522,340	6,270	140,394	1,260,593
<u>1,448,223</u>	<u>615,359</u>	<u>9,128,090</u>	<u>52,569,924</u>
<u>176,642</u>	<u>39,243</u>	<u>265,790</u>	<u>1,994,013</u>
<u>1,624,865</u>	<u>654,602</u>	<u>9,393,880</u>	<u>54,563,937</u>
—	—	27,260	155,869
7,398,858	6,321,107	10,337,554	24,663,339
67,366	1,321,111	1,526,270	3,039,867
—	—	18,857	18,857
—	(11,664)	(8,481)	(8,112,716)
<u>7,466,224</u>	<u>7,630,554</u>	<u>11,901,460</u>	<u>19,765,216</u>
<u>\$ 9,091,089</u>	<u>\$ 8,285,156</u>	<u>\$ 21,295,340</u>	<u>\$ 74,329,153</u>

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

(amounts in thousands)

**Total fund balances – governmental funds** **\$ 19,765,216**

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	18,256,083	
State highway infrastructure	65,268,686	
Collections – nondepreciable	22,630	
Buildings and other depreciable property	26,893,376	
Intangible assets – amortizable	1,027,753	
Less: accumulated depreciation/amortization	(11,604,161)	
Construction in progress	13,916,388	
Intangible assets – nonamortizable	<u>1,375,240</u>	
		115,155,995

- State revenues that are earned and measurable, but not available within 12 months of the end of the reporting period, are reported as deferred inflows of resources in the funds. 1,994,013
- Internal service funds are used by management to charge the costs of certain activities, such as building construction, 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, excluding amounts for activity between the internal service funds and governmental funds. (5,483,510)
- Bond premiums/discounts and prepaid insurance charges are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Position. (3,521,677)
- Deferred inflows and outflows of resources resulting from bond refunding gains and losses, respectively, are amortized over the life of the bonds and are not reported in the funds. 761,882
- General obligation bonds and related accrued interest totaling \$80,162,120, revenue bonds totaling \$7,065,437, and certificates of participation and commercial paper totaling \$598,094 are not due and payable in the current period and are not reported in the funds. (87,825,651)

- The following liabilities are not due and payable in the current period and are not reported in the funds:

Compensated absences	(3,588,310)	
Capital leases	(260,088)	
Net other postemployment benefits obligation	(18,172,547)	
Mandated costs	(7,715,179)	
Workers' compensation	(3,247,861)	
Proposition 98 funding guarantee	(1,519,468)	
Net pension obligation	(3,237,785)	
Pollution remediation obligations	(1,081,966)	
Other noncurrent liabilities	<u>(18,793)</u>	
		(38,841,997)

**Net position of governmental activities** **\$ 2,004,271**

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# Statement of Revenues, Expenditures and Changes in Fund Balances

## Governmental Funds

**Year Ended June 30, 2014**

(amounts in thousands)

	General	Federal
<b>REVENUES</b>		
Personal income taxes .....	\$ 67,584,256	\$ —
Sales and use taxes .....	22,287,696	—
Corporation taxes .....	9,242,454	—
Motor vehicle excise taxes .....	—	—
Insurance taxes .....	2,372,326	—
Other taxes .....	720,206	—
Intergovernmental .....	—	71,364,926
Licenses and permits .....	9,278	—
Charges for services .....	271,117	—
Fees .....	12,015	—
Penalties .....	226,493	26
Investment and interest .....	22,578	—
Escheat .....	487,869	—
Other .....	945,837	—
<b>Total revenues .....</b>	<b>104,182,125</b>	<b>71,364,952</b>
<b>EXPENDITURES</b>		
Current:		
General government .....	4,209,653	1,051,312
Education .....	45,443,261	6,931,926
Health and human services .....	29,126,074	58,139,464
Resources .....	1,144,226	259,857
State and consumer services .....	13,494	5,358
Business and transportation .....	6,735	3,968,256
Correctional programs .....	8,958,251	88,137
Capital outlay .....	1,486,204	—
Debt service:		
Bond and commercial paper retirement .....	1,995,536	74,400
Interest and fiscal charges .....	2,953,651	9,889
<b>Total expenditures .....</b>	<b>95,337,085</b>	<b>70,528,599</b>
Excess (deficiency) of revenues over (under) expenditures .....	8,845,040	836,353
<b>OTHER FINANCING SOURCES (USES)</b>		
General obligation bonds and commercial paper issued .....	—	—
Refunding debt issued .....	—	—
Payment to refund long-term debt .....	—	—
Premium on bonds issued .....	199,162	—
Capital leases .....	1,486,204	—
Transfers in .....	996,459	—
Transfers out .....	(3,915,547)	(822,732)
<b>Total other financing sources (uses) .....</b>	<b>(1,233,722)</b>	<b>(822,732)</b>
Net change in fund balances .....	7,611,318	13,621
<b>Fund balances (deficit) – beginning .....</b>	<b>(15,055,914) *</b>	<b>197,953</b>
<b>Fund balances (deficit) – ending .....</b>	<b>\$ (7,444,596)</b>	<b>\$ 211,574</b>

\* Restated

<u>Transportation</u>	<u>Environmental and Natural Resources</u>	<u>Nonmajor Governmental</u>	<u>Total</u>
\$ —	\$ —	\$ 1,187,411	\$ 68,771,667
638,691	—	13,482,924	36,409,311
—	—	—	9,242,454
5,777,167	—	—	5,777,167
—	—	986,717	3,359,043
5,755	135,662	1,435,402	2,297,025
—	—	1,635,674	73,000,600
4,050,999	367,484	2,529,356	6,957,117
123,437	116,427	258,321	769,302
18,686	2,282,398	6,306,159	8,619,258
39,261	56,252	816,186	1,138,218
10,433	48,219	56,524	137,754
2	—	1,074	488,945
69,078	658,946	1,229,474	2,903,335
<b>10,733,509</b>	<b>3,665,388</b>	<b>29,925,222</b>	<b>219,871,196</b>
199,058	97,949	9,220,242	14,778,214
2,222	3,194	928,833	53,309,436
2,620	153,680	17,359,656	104,781,494
244,712	3,625,155	234,910	5,508,860
101,221	62,587	438,377	621,037
11,462,522	8,329	275,690	15,721,532
—	—	1,348,846	10,395,234
—	253,153	169,653	1,909,010
712,871	280,502	3,939,632	7,002,941
4,303	8,436	1,344,761	4,321,040
<b>12,729,529</b>	<b>4,492,985</b>	<b>35,260,600</b>	<b>218,348,798</b>
(1,996,020)	(827,597)	(5,335,378)	1,522,398
3,211,565	182,365	1,688,375	5,082,305
95,830	351,155	1,630,345	2,077,330
—	(154,651)	(173,373)	(328,024)
83,282	43,970	178,612	505,026
—	—	—	1,486,204
25	240,099	2,804,667	4,041,250
(1,159,155)	(22,663)	(383,950)	(6,304,047)
<b>2,231,547</b>	<b>640,275</b>	<b>5,744,676</b>	<b>6,560,044</b>
235,527	(187,322)	409,298	8,082,442
<b>7,230,697</b>	<b>7,817,876</b>	<b>11,492,162</b> *	<b>11,682,774</b>
<b>\$ 7,466,224</b>	<b>\$ 7,630,554</b>	<b>\$ 11,901,460</b>	<b>\$ 19,765,216</b>

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



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

(amounts in thousands)

**Net change in fund balances – total governmental funds** **\$ 8,082,442**

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	(666,151)	
Disposal of assets	(1,797,155)	
Purchase of assets	<u>5,739,067</u>	
		3,275,761

- Some revenues in the Statement of Activities do not provide current financial resources, and therefore are unavailable in governmental funds. 95,078

- 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, excluding amounts for activity between the internal service funds and governmental funds. (124,281)

- 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	(304,472)	
Revenue bonds	94,211	
Certificates of participation and commercial paper	<u>(59,568)</u>	
		(269,829)

- 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	368,404	
Capital leases	(23,783)	
Net other postemployment benefits obligation	(2,978,601)	
Mandated costs	(1,018,589)	
Workers' compensation	(188,809)	
Proposition 98 funding guarantee	394,596	
Net pension obligation	40,990	
Pollution remediation obligations	(72,750)	
Other noncurrent liabilities	<u>245,930</u>	
		(3,232,612)

**Change in net position of governmental activities** **\$ 7,826,559**

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# Statement of Net Position

## Proprietary Funds

**June 30, 2014**

(amounts in thousands)

	<b>Electric Power</b>	<b>Water Resources</b>
<b>ASSETS</b>		
Current assets:		
Cash and pooled investments .....	\$ —	\$ 466,978
Amount on deposit with U.S. Treasury .....	—	—
Investments .....	—	—
Restricted assets:		
Cash and pooled investments .....	651,000	—
Due from other governments .....	—	—
Net investment in direct financing leases .....	—	—
Receivables (net) .....	—	35,068
Due from other funds .....	3,000	1,129
Due from other governments .....	—	39,429
Prepaid items .....	—	—
Inventories .....	—	5,203
Recoverable power costs (net) .....	156,000	—
Other current assets .....	—	—
Total current assets .....	810,000	547,807
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments .....	629,000	82,728
Investments .....	300,000	72,388
Loans receivable .....	—	—
Investments .....	—	—
Net investment in direct financing leases .....	—	—
Receivables (net) .....	—	—
Interfund receivables .....	—	91,517
Loans receivable .....	—	15,232
Recoverable power costs (net) .....	4,490,000	—
Long-term prepaid charges .....	—	1,214,450
Capital assets:		
Land .....	—	137,033
Collections – nondepreciable .....	—	—
Buildings and other depreciable property .....	—	4,736,960
Intangible assets – amortizable .....	—	36,796
Less: accumulated depreciation/amortization .....	—	(1,994,695)
Construction in progress .....	—	402,520
Intangible assets – non-amortizable .....	—	151,047
Other noncurrent assets .....	—	—
Total noncurrent assets .....	5,419,000	4,945,976
Total assets .....	6,229,000	5,493,783
<b>DEFERRED OUTFLOWS OF RESOURCES .....</b>	<b>80,000</b>	<b>116,741</b>
Total assets and deferred outflows of resources .....	\$ 6,309,000	\$ 5,610,524

<b>Business-type Activities – Enterprise Funds</b>						<b>Governmental Activities</b>
<b>State Lottery</b>	<b>Unemployment Programs</b>	<b>California State University</b>	<b>Nonmajor Enterprise</b>	<b>Total</b>		<b>Internal Service Funds</b>
\$ 316,261	\$ 3,540,926	\$ 445,974	\$ 663,416	\$ 5,433,555	\$	995,075
—	25,215	—	—	25,215		—
116,629	—	2,413,678	—	2,530,307		—
—	—	—	25,975	676,975		3,339,603
—	—	—	20,182	20,182		—
—	—	11,442	—	11,442		406,075
404,239	1,307,800	191,054	32,321	1,970,482		109,934
295	38,516	1,105	672	44,717		441,922
—	40,063	—	206,498	285,990		21,042
—	5,223	43,146	27	48,396		124,378
7,486	—	—	3,124	15,813		76,700
—	—	—	—	156,000		—
5,304	—	—	—	5,304		—
850,214	4,957,743	3,106,399	952,215	11,224,378		5,514,729
—	—	86	—	711,814		402,394
—	—	—	—	372,388		—
—	—	—	305,278	305,278		—
796,206	—	357,153	25,202	1,178,561		—
—	—	358,915	—	358,915		6,576,903
—	32,109	253,902	—	286,011		—
—	611,690	—	5,600	708,807		15,774
—	—	88,251	3,775,587	3,879,070		—
—	—	—	—	4,490,000		—
16,182	—	—	—	1,230,632		8,329
6,469	—	77,364	1,272	222,138		2,312
—	—	7,711	—	7,711		—
157,283	20,103	6,805,714	18,138	11,738,198		660,487
—	166,966	130,789	1,500	336,051		63,217
(68,421)	(16,476)	(2,484,444)	(17,313)	(4,581,349)		(545,849)
—	—	361,545	—	764,065		941,386
—	86,302	11,030	222	248,601		91,167
—	—	17,587	5,586	23,173		—
907,719	900,694	5,985,603	4,121,072	22,280,064		8,216,120
1,757,933	5,858,437	9,092,002	5,073,287	33,504,442		13,730,849
—	—	45,426	—	242,167		118,169
\$ 1,757,933	\$ 5,858,437	\$ 9,137,428	\$ 5,073,287	\$ 33,746,609	\$	13,849,018

(continued)

# Statement of Net Position (continued)

## Proprietary Funds

**June 30, 2014**

(amounts in thousands)

	Electric Power	Water Resources
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 6,000	\$ 78,158
Due to other funds .....	—	47,681
Due to other governments .....	—	85,725
Revenues received in advance .....	—	—
Deposits .....	—	—
Contracts and notes payable .....	—	—
Interest payable .....	48,000	13,188
Benefits payable .....	—	—
Current portion of long-term obligations .....	694,000	191,637
Other current liabilities .....	—	—
Total current liabilities .....	748,000	416,389
Noncurrent liabilities:		
Interfund payables .....	—	—
Loans payable .....	—	—
Lottery prizes and annuities .....	—	—
Compensated absences payable .....	384	29,765
Workers' compensation benefits payable .....	—	—
Certificates of participation, commercial paper, and other borrowings .....	—	36,136
Capital lease obligations .....	—	—
General obligation bonds payable .....	—	184,960
Revenue bonds payable .....	5,555,000	2,532,234
Net other postemployment benefits obligation .....	5,616	176,769
Revenues received in advance .....	—	—
Other noncurrent liabilities .....	—	205,957
Total noncurrent liabilities .....	5,561,000	3,165,821
Total liabilities .....	6,309,000	3,582,210
DEFERRED INFLOWS OF RESOURCES .....	—	822,886
Total liabilities and deferred inflows of resources .....	6,309,000	4,405,096
<b>NET POSITION</b>		
Net investment in capital assets .....	—	994,561
Restricted:		
Nonexpendable – endowments .....	—	—
Expendable:		
Construction .....	—	210,867
Debt service .....	—	—
Security for revenue bonds .....	—	—
Lottery .....	—	—
Unemployment programs .....	—	—
Other purposes .....	—	—
Total expendable .....	—	210,867
Unrestricted .....	—	—
Total net position (deficit) .....	—	1,205,428
Total liabilities, deferred inflows of resources, and net position .....	\$ 6,309,000	\$ 5,610,524

Business-type Activities – Enterprise Funds					Governmental Activities
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ 52,691	\$ 19	\$ 173,638	\$ 2,637	\$ 313,143	\$ 503,197
314,912	59,896	—	1,552	424,041	100,637
—	43,428	—	7	129,160	879
2,979	63,017	256,641	32	322,669	315,022
—	—	—	—	—	429
—	—	—	—	—	15,202
—	—	—	11,444	72,632	118,944
—	482,396	—	—	482,396	—
559,401	—	459,605	26,256	1,930,899	504,843
9	53,247	371,550	126	424,932	105,562
929,992	702,003	1,261,434	42,054	4,099,872	1,664,715
—	—	—	—	—	138,606
—	7,633,391	—	—	7,633,391	—
683,180	—	—	—	683,180	—
—	51,428	98,543	2,739	182,859	166,723
2,538	—	—	—	2,538	43,037
—	—	14,970	—	51,106	—
—	—	1,180,232	—	1,180,232	—
—	—	—	432,357	617,317	—
—	—	3,567,026	415,647	12,069,907	10,822,897
41,114	129,505	267,013	8,405	628,422	444,312
—	—	11,460	—	11,460	—
—	—	166,382	73,709	446,048	21,329
726,832	7,814,324	5,305,626	932,857	23,506,460	11,636,904
1,656,824	8,516,327	6,567,060	974,911	27,606,332	13,301,619
—	—	—	—	822,886	—
1,656,824	8,516,327	6,567,060	974,911	28,429,218	13,301,619
95,330	256,895	714,940	3,824	2,065,550	245,439
—	—	16,219	—	16,219	—
—	—	34,199	—	245,066	282,605
—	—	139	25,975	26,114	4,796
—	—	—	325,460	325,460	—
101,109	—	—	—	101,109	—
—	3,800,470	—	—	3,800,470	—
—	—	44,680	354,415	399,095	—
101,109	3,800,470	79,018	705,850	4,897,314	287,401
(95,330)	(6,715,255)	1,760,191	3,388,702	(1,661,692)	14,559
101,109	(2,657,890)	2,570,368	4,098,376	5,317,391	547,399
\$ 1,757,933	\$ 5,858,437	\$ 9,137,428	\$ 5,073,287	\$ 33,746,609	\$ 13,849,018

(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, 2014**

(amounts in thousands)

	<b>Electric Power</b>	<b>Water Resources</b>
<b>OPERATING REVENUES</b>		
Unemployment and disability insurance .....	\$ —	\$ —
Lottery ticket sales .....	—	—
Power sales .....	(44,000)	131,952
Student tuition and fees .....	—	—
Services and sales .....	—	841,556
Investment and interest .....	—	—
Rent .....	—	—
Grants and contracts .....	—	—
Other .....	—	—
<b>Total operating revenues .....</b>	<b>(44,000)</b>	<b>973,508</b>
<b>OPERATING EXPENSES</b>		
Lottery prizes .....	—	—
Power purchases (net of recoverable power costs) .....	(61,000)	241,444
Personal services .....	—	311,144
Supplies .....	—	—
Services and charges .....	15,000	246,065
Depreciation .....	—	68,896
Scholarships and fellowships .....	—	—
Distributions to beneficiaries .....	—	—
Interest expense .....	—	—
Amortization (recovery) of long-term prepaid charges .....	—	—
Other .....	—	—
<b>Total operating expenses .....</b>	<b>(46,000)</b>	<b>867,549</b>
Operating income (loss) .....	2,000	105,959
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Donations and grants .....	—	—
Private gifts .....	—	—
Investment and interest income .....	879,000	—
Interest expense and fiscal charges .....	(881,000)	(115,499)
Lottery payments for education .....	—	—
Loss on early extinguishment of debt .....	—	—
Other .....	—	9,540
<b>Total nonoperating revenues (expenses) .....</b>	<b>(2,000)</b>	<b>(105,959)</b>
Income (loss) before capital contributions and transfers .....	—	—
Capital contributions .....	—	—
Transfers in .....	—	—
Transfers out .....	—	—
Change in net position .....	—	—
<b>Total net position (deficit) – beginning .....</b>	<b>—</b>	<b>1,205,428</b>
<b>Total net position (deficit) – ending .....</b>	<b>\$ —</b>	<b>\$ 1,205,428</b>

\*Restated

Business-type Activities – Enterprise Funds					Governmental Activities
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ —	\$ 15,160,251	\$ —	\$ —	\$ 15,160,251	\$ —
5,034,661	—	—	—	5,034,661	—
—	—	—	—	87,952	—
—	—	2,123,212	—	2,123,212	—
—	—	458,527	83,524	1,383,607	2,543,093
—	—	—	116,677	116,677	8,173
—	—	—	1,044	1,044	418,574
—	—	73,343	—	73,343	—
—	—	178,656	3,807	182,463	5,143
<b>5,034,661</b>	<b>15,160,251</b>	<b>2,833,738</b>	<b>205,052</b>	<b>24,163,210</b>	<b>2,974,983</b>
3,082,376	—	—	—	3,082,376	—
—	—	—	—	180,444	—
66,109	163,545	4,033,120	14,961	4,588,879	913,906
16,371	—	1,221,702	—	1,238,073	9,821
537,078	85,466	—	87,003	970,612	1,587,712
6,075	7,423	259,201	461	342,056	47,903
—	—	862,479	—	862,479	—
—	13,416,969	—	—	13,416,969	—
—	—	—	38,486	38,486	440,300
—	—	—	—	—	1,496
—	—	—	1,491	1,491	9,393
<b>3,708,009</b>	<b>13,673,403</b>	<b>6,376,502</b>	<b>142,402</b>	<b>24,721,865</b>	<b>3,010,531</b>
1,326,652	1,486,848	(3,542,764)	62,650	(558,655)	(35,548)
—	—	1,491,559	—	1,491,559	—
—	—	39,636	—	39,636	—
43,288	7,007	43,610	1,275	974,180	575
(42,998)	—	(168,434)	(355)	(1,208,286)	(3)
(1,327,928)	—	—	—	(1,327,928)	—
—	—	—	(26,913)	(26,913)	(54,537)
27	—	97,046	(9)	106,604	(1,555)
<b>(1,327,611)</b>	<b>7,007</b>	<b>1,503,417</b>	<b>(26,002)</b>	<b>48,852</b>	<b>(55,520)</b>
(959)	1,493,855	(2,039,347)	36,648	(509,803)	(91,068)
—	—	—	80,903	80,903	—
—	—	2,302,858	—	2,302,858	76,657
—	—	—	(6,848)	(6,848)	(109,870)
(959)	1,493,855	263,511	110,703	1,867,110	(124,281)
<b>102,068</b>	<b>(4,151,745)</b>	<b>2,306,857</b>	<b>3,987,673</b>	<b>3,450,281</b>	<b>671,680</b>
<b>\$ 101,109</b>	<b>\$ (2,657,890)</b>	<b>\$ 2,570,368</b>	<b>\$ 4,098,376</b>	<b>\$ 5,317,391</b>	<b>\$ 547,399</b>



# Statement of Cash Flows

## Proprietary Funds

**Year Ended June 30, 2014**

(amounts in thousands)

	<b>Electric Power</b>	<b>Water Resources</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers/employers .....	\$ (38,000)	\$ 986,586
Receipts from interfund services provided .....	—	—
Payments to suppliers .....	(38,000)	(461,499)
Payments to employees .....	(4,000)	(311,144)
Payments for interfund services used .....	—	—
Payments for Lottery prizes .....	—	—
Claims paid to other than employees .....	—	—
Other receipts (payments) .....	—	46,099
<b>Net cash provided by (used in) operating activities .....</b>	<b>(80,000)</b>	<b>260,042</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Changes in interfund payables and loans payable .....	—	—
Receipt of bond charges .....	864,000	—
Retirement of general obligation bonds .....	—	—
Retirement of revenue bonds .....	(611,000)	—
Interest paid on operating debt .....	(312,000)	—
Transfers in .....	—	—
Transfers out .....	—	—
Grants received .....	—	—
Lottery payments for education .....	—	—
<b>Net cash provided by (used in) noncapital financing activities .....</b>	<b>(59,000)</b>	<b>—</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition of capital assets .....	—	(210,594)
Proceeds from sale of capital assets .....	—	—
Proceeds from notes payable and commercial paper .....	—	108,765
Principal paid on notes payable and commercial paper .....	—	(123,134)
Proceeds from capital leases .....	—	—
Payment on capital debt and leases .....	—	—
Retirement of general obligation bonds .....	—	(61,085)
Proceeds from revenue bonds .....	—	180,159
Retirement of revenue bonds .....	—	(114,775)
Interest paid .....	—	(120,230)
Grants received .....	—	—
<b>Net cash provided by (used in) capital and related financing activities .....</b>	<b>—</b>	<b>(340,894)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments .....	—	(252,174)
Proceeds from maturity and sale of investments .....	—	252,174
Change in interfund receivables and loans receivable .....	—	1,237
Earnings on investments .....	18,000	7,758
<b>Net cash provided by (used in) investing activities .....</b>	<b>18,000</b>	<b>8,995</b>
Net increase (decrease) in cash and pooled investments .....	(121,000)	(71,857)
<b>Cash and pooled investments – beginning .....</b>	<b>1,401,000</b>	<b>621,563</b>
<b>Cash and pooled investments – ending .....</b>	<b>\$ 1,280,000</b>	<b>\$ 549,706</b>

Business-type Activities – Enterprise Funds					Governmental Activities	
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds	
\$ 5,013,487	\$ 15,150,430	\$ 2,583,311	\$ 367,535	\$ 24,063,349	\$ 3,328,192	
—	—	—	419	419	131,813	
(218,881)	(85,464)	(1,175,200)	(85,538)	(2,064,582)	(1,563,512)	
(50,726)	(143,569)	(3,951,474)	(13,533)	(4,474,446)	(843,001)	
(15,070)	(35,075)	—	(950)	(51,095)	(93,495)	
(3,567,224)	—	—	—	(3,567,224)	—	
(345,503)	(13,698,487)	—	—	(14,043,990)	—	
499,198	135,638	(651,704)	(260,098)	(230,867)	(451,504)	
<b>1,315,281</b>	<b>1,323,473</b>	<b>(3,195,067)</b>	<b>7,835</b>	<b>(368,436)</b>	<b>508,493</b>	
—	(951,927)	(1,213)	—	(953,140)	567	
—	—	—	—	864,000	—	
—	—	—	(151,715)	(151,715)	—	
—	—	—	(85,391)	(696,391)	—	
—	—	—	(2,080)	(314,080)	(415)	
—	—	2,302,858	—	2,302,858	76,657	
—	—	—	(6,848)	(6,848)	(109,870)	
—	—	1,618,834	—	1,618,834	—	
(1,415,702)	—	—	—	(1,415,702)	—	
<b>(1,415,702)</b>	<b>(951,927)</b>	<b>3,920,479</b>	<b>(246,034)</b>	<b>1,247,816</b>	<b>(33,061)</b>	
(19,178)	(2,824)	(430,502)	(430)	(663,528)	(1,338,493)	
39	14,467	405	—	14,911	18,558	
—	—	17,733	—	126,498	—	
—	—	—	—	(123,134)	—	
—	—	68,756	—	68,756	—	
—	—	(384,777)	—	(384,777)	—	
—	—	—	—	(61,085)	—	
—	—	464,372	—	644,531	2,323,173	
—	—	(349,702)	—	(464,477)	(412,085)	
—	—	—	—	(120,230)	—	
—	—	26,473	82,351	108,824	—	
<b>(19,139)</b>	<b>11,643</b>	<b>(587,242)</b>	<b>81,921</b>	<b>(853,711)</b>	<b>591,153</b>	
(65,037)	—	(7,743,216)	(2,500)	(8,062,927)	—	
134,853	14,748	7,497,304	—	7,899,079	—	
—	—	—	—	1,237	—	
23,080	7,007	20,721	1,310	77,876	576	
<b>92,896</b>	<b>21,755</b>	<b>(225,191)</b>	<b>(1,190)</b>	<b>(84,735)</b>	<b>576</b>	
(26,664)	404,944	(87,021)	(157,468)	(59,066)	1,067,161	
<b>342,925</b>	<b>3,135,982</b>	<b>533,081</b>	<b>846,859</b>	<b>6,881,410</b>	<b>3,669,911</b>	
<b>\$ 316,261</b>	<b>\$ 3,540,926</b>	<b>\$ 446,060</b>	<b>\$ 689,391</b>	<b>\$ 6,822,344</b>	<b>\$ 4,737,072</b>	

(continued)

# Statement of Cash Flows (continued)

## Proprietary Funds

### Year Ended June 30, 2014

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Operating income (loss) .....	\$ 2,000	\$ 105,959
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt .....	—	—
Depreciation .....	—	68,896
Provisions and allowances .....	—	—
Amortization of premiums and discounts .....	—	—
Amortization of long-term prepaid charges and credits .....	—	(11,996)
Other .....	—	46,098
Change in assets and liabilities:		
Receivables .....	—	57,304
Due from other funds .....	—	—
Due from other governments .....	—	(19,202)
Prepaid items .....	—	—
Inventories .....	—	2,211
Net investment in direct financing leases .....	—	—
Recoverable power costs (net) .....	(94,000)	—
Other current assets .....	14,000	—
Loans receivable .....	—	—
Accounts payable .....	(3,000)	25,290
Due to other funds .....	—	(1,490)
Due to component units .....	—	—
Due to other governments .....	—	(13,028)
Deposits .....	—	—
Contracts and notes payable .....	—	—
Interest payable .....	—	—
Revenues received in advance .....	—	—
Other current liabilities .....	—	—
Benefits payable .....	—	—
Lottery prizes and annuities .....	—	—
Compensated absences payable .....	1,000	—
Other noncurrent liabilities .....	—	—
Total adjustments .....	(82,000)	154,083
<b>Net cash provided by (used in) operating activities .....</b>	<b>\$ (80,000)</b>	<b>\$ 260,042</b>
<b>Noncash investing, capital, and financing activities:</b>		
Interest accreted on annuitized prizes .....	\$ —	\$ —
Interest accreted on zero coupon bonds .....	—	—
Unclaimed Lottery prizes directly allocated to another entity .....	—	—
Impairment loss of utility plant .....	—	11,795
Contributed capital assets .....	—	—
Change in accrued capital asset purchases .....	—	—
Amortization of bond premium and discount .....	—	12,029
Issuance of notes receivable through proceeds from long-term debt .....	—	—
Proceeds from long-term debt received directly by discretely presented component units .....	—	—
Collection of notes receivable used to directly pay long-term debt .....	—	—
Payment of long-term debt made directly by discretely presented component units .....	—	—
Debt restructure and termination of direct financing leases .....	—	—
Other miscellaneous noncash transactions .....	—	7,850

Business-type Activities – Enterprise Funds						Governmental Activities
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds	
\$ 1,326,652	\$ 1,486,848	\$ (3,542,764)	\$ 62,650	\$ (558,655)	\$ (35,548)	
—	—	—	—	—	412	
6,075	7,423	259,201	461	342,056	47,903	
922	—	—	(3,586)	(2,664)	—	
—	—	—	505	505	(44,113)	
3,230	—	—	948	(7,818)	18,058	
12	—	(3,678)	(8,480)	33,952	8,598	
(42,663)	33,778	8,258	2,208	58,885	9,177	
—	(7,220)	1,105	11	(6,104)	71,084	
—	97,362	—	1,450	79,610	5,312	
—	—	(4,187)	(26)	(4,213)	(14,686)	
377	—	—	(425)	2,163	16,304	
—	—	—	8,468	8,468	389,895	
—	—	—	—	(94,000)	—	
464	—	—	98	14,562	—	
—	—	(1,459)	(63,829)	(65,288)	—	
(1,812)	2	(9,710)	(1,662)	9,108	2,795	
(145)	8,777	—	(966)	6,176	(59,044)	
—	—	—	—	—	(2,059)	
—	(6,885)	—	4	(19,909)	585	
—	—	196	—	196	(47)	
—	—	—	—	—	4,487	
—	—	—	(106)	(106)	(3,370)	
(161)	23,957	15,728	(11)	39,513	7,008	
794	8,529	5,006	10,744	25,073	(1,306)	
—	(281,518)	18,839	80	(262,599)	64,971	
14,210	—	—	—	14,210	—	
7,326	(3,868)	10,402	24	14,884	(5,593)	
—	23,844	47,996	(725)	71,115	27,670	
(11,371)	(95,819)	347,697	(54,815)	257,775	544,041	
\$ 1,315,281	\$ 1,391,029	\$ (3,195,067)	\$ 7,835	\$ (300,880)	\$ 508,493	
(concluded)						
\$ 42,998	\$ —	\$ —	\$ —	\$ 42,998	\$ —	
15,608	—	—	—	15,608	—	
21,673	—	—	—	21,673	—	
—	—	—	—	11,795	—	
—	—	20,588	—	20,588	—	
—	—	8,945	—	8,945	—	
—	—	15,068	—	27,097	—	
—	—	40,464	—	40,464	—	
—	—	40,464	—	40,464	—	
—	—	11,685	—	11,685	—	
—	—	11,685	—	11,685	—	
—	—	—	22,006	22,006	114,285	
4,830	—	16,042	—	28,722	—	

# Statement of Fiduciary Net Position

## Fiduciary Funds and Similar Component Units

**June 30, 2014**

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
<b>ASSETS</b>				
Cash and pooled investments .....	\$ 49,896	\$ 2,687,933	\$ 21,131,371	\$ 3,682,227
Investments, at fair value:				
Short-term .....	—	13,010,538	—	—
Equity securities .....	3,218,383	270,858,397	—	—
Debt securities .....	1,844,304	109,483,220	—	—
Real estate .....	188,273	53,253,600	—	—
Other .....	777,884	62,879,102	—	—
Securities lending collateral .....	—	39,699,637	—	—
Total investments .....	6,028,844	549,184,494	—	—
Receivables (net) .....	8,499	5,016,735	—	2,129,562
Due from other funds .....	85,929	567,552	—	20,693,709
Due from other governments .....	—	18,501	—	7,662
Prepaid items .....	—	—	—	28,928
Loans receivable .....	—	22,005	—	7,257
Other assets .....	172,661	930,877	—	93
<b>Total assets .....</b>	<b>6,345,829</b>	<b>558,428,097</b>	<b>21,131,371</b>	<b>\$ 26,549,438</b>
<b>LIABILITIES</b>				
Accounts payable .....	31,335	2,966,302	45	\$ 14,942,369
Due to other governments .....	—	—	11,251	9,984,233
Tax overpayments .....	—	—	—	4,632
Benefits payable .....	—	2,655,305	—	—
Revenues received in advance .....	—	—	—	22,125
Deposits .....	172,661	—	—	987,603
Securities lending obligations .....	—	39,546,799	—	—
Loans payable .....	—	944,269	—	—
Other liabilities .....	938	2,090,618	—	608,476
<b>Total liabilities .....</b>	<b>204,934</b>	<b>48,203,293</b>	<b>11,296</b>	<b>\$ 26,549,438</b>
<b>NET POSITION</b>				
Restricted for pension benefits, pool participants, and other employee benefits .....	<b>\$ 6,140,895</b>	<b>\$ 510,224,804</b>	<b>\$ 21,120,075</b>	

# Statement of Changes in Fiduciary Net Position

## Fiduciary Funds and Similar Component Units

**Year Ended June 30, 2014**

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
<b>ADDITIONS</b>			
Contributions:			
Employer .....	\$ —	\$ 14,397,367	\$ —
Plan member .....	—	6,958,991	—
Total contributions .....	—	21,356,358	—
Investment income:			
Net appreciation (depreciation) in fair value of investments .....	512,830	71,480,345	—
Interest, dividends, and other investment income .....	244,806	8,581,008	50,201
Less: investment expense .....	(4,023)	(1,771,132)	—
Net investment income .....	753,613	78,290,221	50,201
Receipts from depositors .....	3,059,755	—	21,647,510
Other .....	—	32,452	—
<b>Total additions .....</b>	<b>3,813,368</b>	<b>99,679,031</b>	<b>21,697,711</b>
<b>DEDUCTIONS</b>			
Distributions paid and payable to participants .....	—	31,006,086	48,512
Refunds of contributions .....	—	444,619	—
Administrative expense .....	3	565,212	1,689
Interest expense .....	—	—	—
Payments to and for depositors .....	2,827,126	618,801	21,739,535
<b>Total deductions .....</b>	<b>2,827,129</b>	<b>32,634,718</b>	<b>21,789,736</b>
Change in net position .....	986,239	67,044,313	(92,025)
<b>Net position – beginning .....</b>	<b>5,154,656</b>	<b>443,180,491</b>	<b>21,212,100</b>
<b>Net position – ending .....</b>	<b>\$ 6,140,895</b>	<b>\$ 510,224,804</b>	<b>\$ 21,120,075</b>

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# **Discretely Presented Component Units Financial Statements**





# Statement of Net Position

## Discretely Presented Component Units – Enterprise Activity

**June 30, 2014**

(amounts in thousands)

	<b>University of California</b>	<b>California Housing Finance Agency</b>
<b>ASSETS</b>		
Current assets:		
Cash and pooled investments .....	\$ 322,711	\$ 1,081,220
Investments .....	4,717,181	100,943
Restricted assets:		
Cash and pooled investments .....	—	—
Investments .....	—	—
Receivables (net) .....	3,167,380	172,460
Due from primary government .....	205,129	—
Due from other governments .....	97,342	—
Prepaid items .....	—	534
Inventories .....	194,615	—
Other current assets .....	208,674	14,145
Total current assets .....	<u>8,913,032</u>	<u>1,369,302</u>
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments .....	—	—
Investments .....	—	—
Investments .....	25,686,412	403,112
Receivables (net) .....	2,488,712	—
Loans receivable .....	—	3,781,555
Long-term prepaid charges .....	—	—
Capital assets:		
Land .....	863,455	—
Collections – nondepreciable .....	382,277	—
Buildings and other depreciable property .....	41,502,981	1,782
Intangible assets – amortizable .....	823,393	—
Less: accumulated depreciation/amortization .....	(19,569,114)	(940)
Construction in progress .....	3,642,165	—
Intangible assets – non-amortizable .....	—	—
Other noncurrent assets .....	286,504	16,681
Total noncurrent assets .....	<u>56,106,785</u>	<u>4,202,190</u>
Total assets .....	<u><b>65,019,817</b></u>	<u><b>5,571,492</b></u>
DEFERRED OUTFLOWS OF RESOURCES .....	<u><b>3,705,459</b></u>	<u><b>25,710</b></u>
Total assets and deferred outflows of resources .....	<u><b>\$ 68,725,276</b></u>	<u><b>\$ 5,597,202</b></u>

Nonmajor Component Units		Total	
\$	949,157	\$	2,353,088
	404,400		5,222,524
	128,517		128,517
	15,929		15,929
	447,432		3,787,272
	1,212		206,341
	—		97,342
	742		1,276
	—		194,615
	32,349		255,168
	1,979,738		12,262,072
	26,725		26,725
	14,286		14,286
	1,841,034		27,930,558
	252,630		2,741,342
	285,454		4,067,009
	—		—
	139,066		1,002,521
	8,401		390,678
	1,995,127		43,499,890
	12,578		835,971
	(972,702)		(20,542,756)
	19,357		3,661,522
	5,082		5,082
	50,751		353,936
	3,677,789		63,986,764
	<b>5,657,527</b>		<b>76,248,836</b>
	<b>6,069</b>		<b>3,737,238</b>
\$	<b>5,663,596</b>	\$	<b>79,986,074</b>

(continued)

# Statement of Net Position (continued)

## Discretely Presented Component Units – Enterprise Activity

**June 30, 2014**

(amounts in thousands)

	<b>University of California</b>	<b>California Housing Finance Agency</b>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 1,483,299	\$ 89,309
Due to other governments .....	—	—
Revenues received in advance .....	1,061,477	—
Deposits .....	561,009	227,493
Contracts and notes payable .....	—	—
Interest payable .....	—	58,170
Securities lending obligations .....	1,269,083	—
Current portion of long-term obligations .....	3,432,534	74,248
Other current liabilities .....	1,532,342	599
<b>Total current liabilities</b> .....	<b>9,339,744</b>	<b>449,819</b>
Noncurrent liabilities:		
Compensated absences payable .....	262,593	—
Workers' compensation benefits payable .....	321,055	—
Certificates of participation, commercial paper, and other borrowings .....	—	—
Capital lease obligations.....	88,622	—
Revenue bonds payable .....	15,424,508	3,526,190
Net other postemployment benefits obligation .....	8,440,303	22,295
Net pension obligation .....	7,725,075	—
Other noncurrent liabilities .....	1,206,888	201,429
<b>Total noncurrent liabilities</b> .....	<b>33,469,044</b>	<b>3,749,914</b>
<b>Total liabilities</b> .....	<b>42,808,788</b>	<b>4,199,733</b>
<b>DEFERRED INFLOWS OF RESOURCES</b> .....	<b>7,108,562</b>	<b>—</b>
<b>Total liabilities and deferred inflows of resources</b> .....	<b>49,917,350</b>	<b>4,199,733</b>
<b>NET POSITION</b>		
Net Investment in capital assets .....	12,166,807	842
Restricted:		
Nonexpendable – endowments.....	4,343,651	—
Expendable:		
Endowments and gifts .....	9,903,548	—
Education .....	783,994	—
Indenture .....	—	491,187
Employee benefits .....	—	—
Workers' compensation liability .....	—	—
Statute .....	—	986,565
Other purposes .....	—	—
<b>Total expendable</b> .....	<b>10,687,542</b>	<b>1,477,752</b>
Unrestricted .....	(8,390,074)	(81,125)
<b>Total net position</b> .....	<b>18,807,926</b>	<b>1,397,469</b>
<b>Total liabilities, deferred inflows of resources, and net position</b> .....	<b>\$ 68,725,276</b>	<b>\$ 5,597,202</b>

Nonmajor Component Units		Total	
\$	265,990	\$	1,838,598
	54,967		54,967
	66,239		1,127,716
	1,549		790,051
	16,326		16,326
	2,764		60,934
	—		1,269,083
	298,756		3,805,538
	288,847		1,821,788
	995,438		10,785,001
	12,691		275,284
	283		321,338
	20,255		20,255
	360,026		448,648
	237,203		19,187,901
	117,649		8,580,247
	—		7,725,075
	515,950		1,924,267
	1,264,057		38,483,015
	<b>2,259,495</b>		<b>49,268,016</b>
	<b>1,561</b>		<b>7,110,123</b>
	<b>2,261,056</b>		<b>56,378,139</b>
	515,314		12,682,963
	945,897		5,289,548
	9,378		9,912,926
	924,763		1,708,757
	—		491,187
	—		—
	—		—
	281,696		1,268,261
	25,769		25,769
	1,241,606		13,406,900
	699,723		(7,771,476)
	<b>3,402,540</b>		<b>23,607,935</b>
<b>\$</b>	<b>5,663,596</b>	<b>\$</b>	<b>79,986,074</b>
			(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, 2014

(amounts in thousands)

	University of California	California Housing Finance Agency
<b>OPERATING EXPENSES</b>		
Personal services .....	\$ 17,267,563	\$ 29,703
Scholarships and fellowships .....	577,212	—
Supplies .....	2,584,968	—
Services and charges .....	290,444	29,572
Department of Energy laboratories .....	1,244,335	—
Depreciation .....	1,739,612	264
Interest expense and fiscal charges .....	617,000	122,277
Grants provided .....	642,809	—
Other .....	3,750,169	53,348
<b>Total operating expenses .....</b>	<b>28,714,112</b>	<b>235,164</b>
<b>PROGRAM REVENUES</b>		
Charges for services .....	16,945,088	38,783
Operating grants and contributions .....	8,051,387	53,462
Capital grants and contributions .....	473,464	—
<b>Total program revenues .....</b>	<b>25,469,939</b>	<b>92,245</b>
Net revenues (expenses) .....	(3,244,173)	(142,919)
<b>GENERAL REVENUES</b>		
Investment and interest income .....	2,972,157	171,294
Other .....	2,502,492	22,899
<b>Total general revenues .....</b>	<b>5,474,649</b>	<b>194,193</b>
Change in net position .....	2,230,476	51,274
<b>Net position – beginning .....</b>	<b>16,577,450 *</b>	<b>1,346,195 *</b>
<b>Net position – ending .....</b>	<b>\$ 18,807,926</b>	<b>\$ 1,397,469</b>

\* Restated

Nonmajor Component Units		Total
\$	500,490	\$ 17,797,756
	54,938	632,150
	10,726	2,595,694
	1,272,317	1,592,333
	—	1,244,335
	74,536	1,814,412
	34,895	774,172
	—	642,809
	69,477	3,872,994
	<b>2,017,379</b>	<b>30,966,655</b>
	1,069,909	18,053,780
	564,519	8,669,368
	9,147	482,611
	<b>1,643,575</b>	<b>27,205,759</b>
	(373,804)	(3,760,896)
	253,750	3,397,201
	433,862	2,959,253
	<b>687,612</b>	<b>6,356,454</b>
	313,808	2,595,558
	<b>3,088,732 *</b>	<b>21,012,377</b>
\$	<b>3,402,540</b>	<b>\$ 23,607,935</b>

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# Notes to the Financial Statements

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2014:

GASB Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*; and

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, requires governments that extend a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee.

### 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, email the State Controller's Office, Division of Accounting and Reporting at [StateGovReports@sco.ca.gov](mailto:StateGovReports@sco.ca.gov).

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. CalPERS' separately issued financial statements may be obtained from the California Public Employees' Retirement System on its website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

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 the following 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. CalSTRS' separately issued financial statements may be obtained from the California State Teachers' Retirement System on its website at [www.CalSTRS.com](http://www.CalSTRS.com).

## 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. Most component units separately issue their own financial statements. In general, the notes to the financial statements in this publication do not include information found in the component units' separately issued financial statements. Instead, references to the individual component unit financial statements are provided where applicable.

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. The University of California's financial statements may be obtained from the University of California on its website at [www.ucop.edu](http://www.ucop.edu).

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. CalHFA's financial statements may be obtained from the California Housing Finance Agency on its website at [www.CalHFA.ca.gov](http://www.CalHFA.ca.gov).

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, email the State Controller's Office, Division of Accounting and Reporting at [StateGovReports@sco.ca.gov](mailto:StateGovReports@sco.ca.gov).

The nonmajor consolidated component units segments are:

*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.

*Financing authorities*, which provide financing for specific purposes. These agencies include:

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

*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, 2013).

*Other component units*, which include the following entities:

- 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 *Public Employees' Contingency Reserve*, which provides health benefit plans for state employees and annuitants.

#### 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, 2014, CADA had total assets of \$31.4 million, total liabilities of \$19.7 million, and total net position of \$11.7 million. Total revenues for the fiscal year were \$10.5 million and expenses were \$11.3 million, resulting in a decrease in net position of \$800,000. 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 or on its website at [www.cadanet.org](http://www.cadanet.org).

#### 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 Independent System Operator, P.O. Box 639014, Folsom, California 95763-9014 or go to its website at [www.caiso.com](http://www.caiso.com).

The *California Earthquake Authority (CEA)*, a legally separate organization, offers earthquake insurance for California homeowners, renters, condominium owners, and mobilehome owners. A three-member board of state-elected officials governs the CEA. The State's 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 or go to its website at [www.earthquakeauthority.com](http://www.earthquakeauthority.com).



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 11 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 the State Compensation Insurance Fund, 333 Bush Street, 8th Floor, San Francisco, California 94104 or go to its website at [www.statefundca.com](http://www.statefundca.com).

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 or go to its website at [www.treasurer.ca.gov/cpcfa](http://www.treasurer.ca.gov/cpcfa).

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 or go to its website at [www.treasurer.ca.gov/chffa](http://www.treasurer.ca.gov/chffa).

The *California Educational Facilities Authority (CEFA)* was created by 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 or go to its website at [www.treasurer.ca.gov/cefa](http://www.treasurer.ca.gov/cefa).



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 or go to its website at [www.treasurer.ca.gov/csfa/](http://www.treasurer.ca.gov/csfa/).

## B. Government-wide and Fund Financial Statements

Government-wide financial statements (the Statement of Net Position and the Statement of Activities) provide information on all of 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 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 need not 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 that are all restricted by federal regulations.

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 restricted 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 restricted 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 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 *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, public building 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 unassigned 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. When an asset is recorded in a governmental fund statement, but the revenue is not available per the criterion described herein, the State reports a deferred inflow of resources until such time the revenue becomes available. 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. Cash and Investments**

The State considers cash and pooled investments, for the purpose of the Statement of Cash Flows, as cash and cash equivalents. Cash and cash equivalents are considered to be cash on hand, deposits in the State's pooled investment program, restricted cash and pooled investments for debt service, construction and operations, restricted cash on deposit with fiscal agents (for example, revenue bond trustees), and highly liquid investments with an original maturity date of three months or less.

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.

## **E. Receivables**

Amounts are aggregated into a single receivables account net of allowance for uncollectible amounts. The detail of the primary government's accounts receivable can be found in Note 4, Accounts Receivable.

## **F. 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.

## **G. Net Investment in Direct Financing Leases**

The State Public Works Board accounts for its activities in the Public Buildings Construction Fund, an internal service fund, and has entered into lease-purchase agreements with various other primary government agencies 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 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 in the internal service fund financial statements. As the majority of this lease receivable is from governmental funds, it is eliminated within the governmental activities column of the government-wide Statement of Net Position.

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

## **H. 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 on revenue bonds issued. Long-term prepaid charges are also included in the State Lottery Fund and nonmajor enterprise funds. These prepaid charges 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. In the government-wide financial statements, the prepaid charges for governmental activities includes prepaid insurance costs on revenue bonds issued.

## **I. 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 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.



## J. 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 (OPEB), 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 deferred and amortized over the life of the bonds. In these instances, bonds payable is reported net of the applicable premium and discount. Bond premiums and discounts for governmental funds are reported as other financing sources (uses). However, in the government-wide financial statements, the bonds payable for governmental activities is reported net of the applicable unamortized premium and discount. Bond issuance costs, excluding prepaid insurance, are expensed when incurred.

With advance approval 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 fund, the liability for revenue bonds is recorded in the respective fund.

## K. 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 governmental fund financial statements, only the compensated absences liability for employees who have left state service and have unused reimbursable leave at year end is 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.

## L. Deferred Outflows and Deferred Inflows of Resources

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

### 1. Deferred Outflows of Resources

Deferred outflows of resources are the consumption of assets that are applicable to future reporting periods. Deferred outflows of resources are presented separately after “Total Assets” in the Balance Sheet and Statement of Net Position.

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

- *Loss on Refunding of Debt:* The defeasance of previously outstanding general obligation and revenue bonds resulted in deferred refunding losses for governmental activities, business-type activities, and component units. These deferred losses are recognized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.
- *Decrease in Fair Value of Hedging Derivatives:* Negative changes in the fair value of hedging derivatives are reported for business-type activities and component units.
- *Net Pension Liability:* The University of California, a discretely presented component unit, reports the decreases in its net pension liability that were not included in its pension expense as deferred outflows of resources. Also, employer contributions subsequent to the measurement date of the net pension liability are reported as deferred outflows of resources.

### 2. Deferred Inflows of Resources

Deferred inflows of resources are the acquisition of assets that are applicable to future reporting periods. Deferred inflows of resources are presented separately after “Total Liabilities” in the Balance Sheet and Statement of Net Position.

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

- *Gain on Refunding of Debt:* The defeasance of previously outstanding general obligation and revenue bonds resulted in deferred refunding gains for governmental activities and discretely presented component units. These deferred gains are recognized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.
- *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. The upfront payment received or present value of installment payments expected to be received from the third parties are reported as deferred inflows of resources.
- *Net Pension Liability:* The University of California reports the increases in its net pension liability that were not included in pension expense as deferred inflows of resources.
- *Other Deferred Inflows of Resources:* Revenues generated from current rates charged by regulated business-type activities that are intended to recover costs expected to be incurred in the future are reported in the government-wide Statement of Net Position. Revenues that are earned and measurable, but not available within 12 months of the end of the reporting period, are reported in the governmental funds’ balance sheet.



## M. Abnormal Account Balances

In the 2013-14 fiscal year, the Water Resources Electric Power Fund had a net refund of \$44 million of 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 2013-14 fiscal year, the fund returned \$93 million through adjustments to power charges and through separate monthly payments to its ratepayers.

## N. 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 of 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.

## O. 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 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, 2014, the government-wide financial statements show restricted net position for the primary government of \$28.9 billion, of which \$6.8 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 financial statements. Fund balance amounts for governmental funds are reported as nonspendable, restricted, committed, assigned, or unassigned.

*Nonspendable* fund balance includes amounts that cannot be spent because they are not in spendable form (inventories; prepaid amounts; long-term portion of loans or notes receivable; or property held for resale

unless the proceeds are restricted, committed, or assigned) or they are legally or contractually required to remain intact.

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

*Committed* fund balance 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, the California State Legislature. The formal action that commits fund balance to a specific purpose occurred 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 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 reported as nonspendable, restricted, or committed are classified as assigned for the purpose of the respective funds.

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

*Fund balance spending order:* For the purpose of reporting fund balance in this financial report 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.

Fiduciary fund net position is amounts held in trust for benefits and other purposes.

## P. Restatement of Beginning Fund Balances and Net Position

### 1. Fund Financial Statements

The beginning fund balance of *governmental funds* decreased by a net total of \$566 million. This decrease is comprised of an understatement of \$444 million for education expenditures that support community colleges and an overstatement of \$357 million of retail sales tax revenue in the *General Fund*, and the following restatements in *nonmajor governmental funds*:

- \$212 million increase as a result of a change in the tobacco settlement revenue recognition methodology in the *Golden State Tobacco Securitization Corporation Fund*;
- \$26 million increase due to the understatement of retail sales tax revenue in the *Economic Recovery Bond Sinking Fund*; and
- \$3 million decrease due to the movement of a fund previously reported within the *Financing for Local Governments and the Public* special revenue fund that is now administered by a discretely presented component unit reported within the *financing authorities* consolidated nonmajor component unit segment.

The beginning net position of the *internal service funds* increased by \$419 million. This increase is comprised of \$368 million, as adjusted for capitalized interest of \$11.8 million, due to the reclassification of the *Public Building Construction Fund* from an enterprise fund to an internal service fund. The remaining \$51 million increase resulted from understated capital assets and understated revenue in the *Financial Information Systems Fund*.

The beginning net position of the *enterprise funds* decreased by \$616 million. The decrease is comprised of the \$380 million prior year net position of the *Public Buildings Construction Fund* that was reclassified from an enterprise fund to an internal service fund and the \$236 million transfer of capital lease obligation from governmental activities to the *California State University Fund*, a major enterprise fund.

Beginning net position of the *discretely presented component units* decreased by \$6.3 billion. This decrease is primarily the result of the *University of California's* implementation of GASB Statement No. 65 and GASB Statement No. 68, as well as a change in its reporting entity. Further information related to these restatements is included in the University's separately issued financial statements which can be obtained from the University on its website at [www.ucop.edu](http://www.ucop.edu). In addition, other component units had small restatements to their beginning net position as follows:

- \$39 million increase for understated loans receivable of the *California Housing Finance Agency*;
- \$6 million decrease for OPEB obligation and other adjustments of the *California State University Auxiliary Organizations*;
- \$3 million increase due to the movement of a fund previously reported as a special revenue fund by the primary government to the *financing authorities* consolidated nonmajor component unit segment; and
- \$239,000 net increase for the implementation of GASB 65, understated liabilities, and unrecorded capital assets for the *district agricultural associations*.

## 2. Government-wide Financial Statements

The beginning net position of the *governmental activities* increased by \$2.3 billion. In addition to the amounts described in the previous section for governmental funds, the restatement comprises a \$2.2 billion increase for understated capital assets and the \$236 million increase for the transfer from governmental activities of capital lease obligations of the *California State University Fund* described in the previous section for enterprise funds.

The beginning net position of *business-type activities* and *component units* were restated as described in the previous section for enterprise funds and discretely presented component units, respectively.

## Q. Guaranty Deposits

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

## NOTE 2: BUDGETARY AND LEGAL COMPLIANCE

### A. Budgeting and Budgetary Control

The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues, but 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, 2014, increased spending authority for the budgetary/legal basis reported General Fund, and decreased spending authority for the Environmental and Natural Resources Funds and Transportation Funds.

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

### B. Legal Compliance

State agencies are responsible for exercising basic budgetary control and ensuring that appropriations are not overspent. The State Controller's Office is responsible for overall appropriation control and does not allow expenditures in excess of authorized appropriations.

Financial activities are mainly controlled at the appropriation level but can vary, depending on the presentation and wording contained in the Budget Act. The Budget Act appropriations are identified by department, reference item, and fund. The annual appropriated budget may establish detailed allocations to specific programs, projects, or sources of reimbursement within an appropriation. The Department of Finance can authorize adjustments between the detail allocations but cannot increase the amount of the overall appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control—the extent to which management may amend the budget without seeking approval of the governing body—has been established in the Budget Act for the annual operating budget.

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 Codification of Governmental Accounting and Financial Reporting Standards, Section 2400.121. The supplement 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 by emailing the State Controller's Office, Division of Accounting and Reporting at [StateGovReports@sco.ca.gov](mailto:StateGovReports@sco.ca.gov).

## NOTE 3: DEPOSITS AND INVESTMENTS

Cash balances not required for immediate use are invested by the State Treasurer. 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.

### A. Primary Government

#### 1. Control of State Funds

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 and a related organization participate in the State Treasurer's Office pooled investment program. As of June 30, 2014, the discretely presented component units and the related organization account for approximately 3.2% 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 that compensates the banks for their services.

Demand and time deposits held by financial institutions as of June 30, 2014, totaling approximately \$7.3 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, 2014, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling \$19 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.

Certain funds have elected to participate in the pooled investment program even though they have the authority to invest on their own. Others may be required by legislation to participate in the program; as a result, the deposits of these funds may be considered involuntary. However, these funds are part of the State's reporting entity. The remaining participant 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 assigned to the State's General Fund. Most of the \$16 million in interest revenue received by the General Fund from the pooled investment program in fiscal year 2013-14 was earned on balances in these funds.

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

## **2. Valuation of State Investments**

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 can be obtained from the State Treasurer's Office website at [www.treasurer.ca.gov](http://www.treasurer.ca.gov).

As of June 30, 2014, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 239 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.

## **3. Oversight of Investing Activities**

The Pooled Money Investment Board (PMIB) 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 PMIB 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, 2014, 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.

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, 2014, medium-term asset-backed securities comprised approximately 1.19% of the pooled investments. The asset-backed securities consist 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 SBA 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 were short-term, asset-backed commercial paper (ABCP), which represented 0.84% of the pooled investments.

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. Maturities are limited by the State Treasurer's Office Investment Policy for the Pooled Money Investment Program. For commercial paper, the Investment Policy is more restrictive than the Government Code. For corporate bonds and notes, the Government Code requires that a security fall within the top three ratings of a nationally recognized statistical ratings organization (NASRO). Items reported as N/A have no limitation in either the Government Code or the State Treasurer's Office Investment Policy.

**Table 1**

**Authorized Investments**

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer	Credit Rating
U.S. Treasury securities	5 years	N/A	N/A	N/A
Federal agency 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
Corporate bonds/notes	5 years	N/A	N/A	A-/A3/A-
Repurchase agreements	1 year	N/A	N/A	N/A
Reverse repurchase agreements	1 year	10%	N/A	N/A

#### 4. Risk of Investments

The following types of risks are common in deposits and investments, including those of the State:

*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. Interest Rate Risk**

Table 2 presents the interest rate risk of the primary government's investments. In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes that stated maturity is the quarterly reset date. Total pooled investments do not include \$4.8 billion of time deposits and \$314 million of internal loans to state funds. Repurchase agreements of the California State University system mature in one day. Most mortgage-backed securities are issued by U.S. government agencies, or government-sponsored enterprises such as the Federal National Mortgage Association, and entitle the purchaser to receive a share of the cash flows, such as principal and interest payments, from a pool of mortgages. Mortgage-backed securities are highly sensitive to interest rate changes because principal prepayments either increase (in a low interest rate environment) or decrease (in a high interest rate environment) the security yield. As of June 30, 2014, only \$130 million, or 0.22% of the total pooled investments, was invested in mortgage-backed securities.

**Table 2****Schedule of Investments – Primary Government – Interest Rate Risk**

June 30, 2014

(amounts in thousands)

	Fair Value at Year End	Weighted Average Maturity (in years)
<b>Pooled investments</b>		
U.S. Treasury bills and notes .....	\$ 34,926,335	0.94
U.S. Agency bonds and discount notes .....	4,685,570	0.50
Supranatural debentures and discount notes (IBRD) .....	150,040	1.56
Small Business Administration loans .....	581,690	0.25
Mortgage-backed securities .....	130,274	2.37
Certificates of deposit .....	11,993,881	0.22
Bank notes .....	599,930	0.14
Commercial paper .....	6,698,100	0.11
<b>Total pooled investments .....</b>	<b>59,765,820</b>	
<b>Other primary government investments</b>		
U.S. Treasuries and agencies .....	2,285,376	2.58
Commercial paper .....	252,683	0.73
Guaranteed investment contracts .....	210,327	8.66
Corporate debt securities .....	1,011,356	2.08
Repurchase agreements .....	2,274	0.00
Other .....	953,463	3.49
<b>Total other primary government investments .....</b>	<b>4,715,479</b>	
<b>Funds outside primary government included in pooled investments</b>		
Less: investment trust funds .....	21,104,087	
Less: other trust and agency funds .....	1,750,530	
Less: discretely presented component units and related organizations .....	1,901,592	
<b>Total primary government investments .....</b>	<b>\$ 39,725,090</b>	



## b. Credit Risk

Table 3 presents the credit risk of the primary government's debt securities. If a particular security has multiple ratings, the lowest rating of the three major NASROs is used. Similar to interest rate risk shown in Table 2, time deposits and internal loans to state funds are not included.

**Table 3**

### Schedule of Investments in Debt Securities – Primary Government – Credit Risk

June 30, 2014

(amounts in thousands)

Credit Rating as of Year End		
Short-term	Long-term	Fair Value
Pooled investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 10,594,908
A-1/P-1/F-1	AA/Aa/AA	13,532,613
Not rated .....		130,274
Not applicable .....		35,508,025
Total pooled investments .....		\$ 59,765,820
Other primary government investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 917,961
A-1/P-1/F-1	AA/Aa/AA	1,782,457
A-2/P-2/F-2	A/A/A	768,419
A-3/P-3/F-3	BBB/Baa/BBB	27,441
Not rated .....		444,488
Not applicable .....		774,713
Total other primary government investments .....		\$ 4,715,479

## c. 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, 2014, one guaranteed investment contract of the Electric Power Fund in the amount of \$100 million was uninsured and uncollateralized.

## d. 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. As of June 30, 2014, the State did not hold debt securities in any one issuer (other than U.S. Treasury securities) that represented 5% or more of the primary government investments.

## **B. Fiduciary Funds**

The fiduciary funds include pension and other employee benefit trust funds of the following fiduciary funds and component units: California Public Employees' Retirement System (CalPERS), 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.

Additional disclosure for CalPERS' investments and derivative instruments is included in CalPERS' separately issued financial statements, which can be obtained from CalPERS on its website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov). Additional disclosure for CalSTRS' investments and derivative instruments is included in CalSTRS' separately issued financial statements, which can be obtained from CalSTRS on its website at [www.CalSTRS.com](http://www.CalSTRS.com).

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

The discretely presented component units consist of the University of California and its foundation, the California Housing Finance Agency (CalHFA), and various nonmajor component units. The University and CalHFA constitute 93% 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 nonmajor component units are invested in the State Treasurer's pooled investment program.

Additional disclosures for the University of California's investments and derivative instruments are included in the University's separately issued financial statements, which can be obtained from the University on its website at [www.ucop.edu](http://www.ucop.edu). Additional disclosure for CalHFA's investments and derivative instruments is included in CalHFA's separately issued financial statements, which can be obtained from CalHFA on its website at [www.CalHFA.ca.gov](http://www.CalHFA.ca.gov).

**NOTE 4: ACCOUNTS RECEIVABLE**

Table 4 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 4****Schedule of Accounts Receivable**

June 30, 2014

(amounts in thousands)

	<b>Taxes</b>	<b>Lottery Retailers</b>	<b>Unemployment Programs</b>
<b>Current governmental activities</b>			
General Fund .....	\$ 12,482,261	\$ —	\$ —
Federal Fund .....	—	—	—
Transportation Fund .....	638,349	—	—
Environmental and Natural Resources Fund .....	—	—	—
Nonmajor governmental funds .....	435,737	—	—
Internal service funds .....	—	—	—
Adjustment:			
Unavailable revenue <sup>1</sup> .....	(1,608,039)	—	—
<b>Total current governmental activities .....</b>	<b>\$ 11,948,308</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Amounts not scheduled for collection</b>			
<b>during the subsequent year (unavailable revenue) .....</b>	<b>\$ 1,608,039</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Current business-type activities</b>			
Water Resources Fund .....	\$ —	\$ —	\$ —
State Lottery Fund .....	—	404,239	—
Unemployment Programs Fund .....	—	—	1,307,800
California State University .....	—	—	—
Nonmajor enterprise programs .....	—	—	—
<b>Total current business-type activities .....</b>	<b>\$ —</b>	<b>\$ 404,239</b>	<b>\$ 1,307,800</b>
<b>Amounts not scheduled for collection</b>			
<b>during the subsequent year (unavailable revenue) .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 32,109</b>

<sup>1</sup> The unavailable revenue reported in the governmental fund financial statements represents revenues that are earned and measurable, but not available within 12 months of the end of the reporting period.

<sup>2</sup> Amount includes noncurrent receivables for service concession arrangements of \$64 million that were not included in the governmental fund financial statements.

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<b>California State University</b>	<b>Other</b>	<b>Total</b>
\$ —	\$ 683,690	\$ 13,165,951
—	12,520	12,520
—	490,805	1,129,154
—	523,853	523,853
—	3,021,169	3,456,906
—	109,934	109,934
—	(385,974)	(1,994,013)
<u>\$ —</u>	<u>\$ 4,455,997</u>	<u>\$ 16,404,305</u>
<u>\$ —</u>	<u>\$ 450,350</u> <sup>2</sup>	<u>\$ 2,058,389</u>
\$ —	\$ 35,068	\$ 35,068
—	—	404,239
—	—	1,307,800
191,054	—	191,054
—	32,321	32,321
<u>\$ 191,054</u>	<u>\$ 67,389</u>	<u>\$ 1,970,482</u>
<u>\$ 253,902</u>	<u>\$ —</u>	<u>\$ 286,011</u>

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**NOTE 5: RESTRICTED ASSETS**

Table 5 presents a summary of the legal restrictions placed on assets of the primary government and the discretely presented component units.

**Table 5****Schedule of Restricted Assets**

June 30, 2014

(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
<b>Primary government</b>					
Debt service .....	\$ 1,725,392	\$ 372,388	\$ 20,182	\$ 305,278	\$ 2,423,240
Construction .....	3,254,758	—	—	—	3,254,758
Operations .....	147,000	—	—	—	147,000
Other .....	3,636	—	—	—	3,636
<b>Total primary government .....</b>	<b>5,130,786</b>	<b>372,388</b>	<b>20,182</b>	<b>305,278</b>	<b>5,828,634</b>
<b>Discretely presented component units</b>					
Debt service .....	155,242	30,215	—	—	185,457
<b>Total discretely presented component units .....</b>	<b>155,242</b>	<b>30,215</b>	<b>—</b>	<b>—</b>	<b>185,457</b>
<b>Total restricted assets .....</b>	<b>\$ 5,286,028</b>	<b>\$ 402,603</b>	<b>\$ 20,182</b>	<b>\$ 305,278</b>	<b>\$ 6,014,091</b>

**NOTE 6: NET INVESTMENT IN DIRECT FINANCING LEASES**

The State Public Works Board (SPWB) accounts for its activities in the Public Buildings Construction Fund, an internal service fund, and has entered into lease-purchase agreements with various other primary government agencies and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the SPWB. The lease-purchase activity between the SPWB and the primary government agencies shown in the schedule below represents only that activity with agencies reported as enterprise funds. The lease receivable of \$6.0 billion from governmental funds along with the corresponding lease obligation was eliminated within the governmental activities column of the government-wide Statement of Net Position.

California State University System (CSU) accounts for its lease activities in the California State University 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 6 summarizes the minimum lease payments to be received by the primary government.

**Table 6**

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

(amounts in thousands)

Year Ending June 30	State Public Works Board			California State University
	Primary Government Agencies	Local Agencies	Total	
2015 .....	\$ 96,981	\$ 62,177	\$ 159,158	\$ 29,305
2016 .....	93,299	53,892	147,191	26,639
2017 .....	91,228	39,986	131,214	26,930
2018 .....	78,068	32,698	110,766	27,014
2019 .....	68,417	26,183	94,600	27,039
2020-2024 .....	263,993	64,282	328,275	144,956
2025-2029 .....	214,944	63,317	278,261	145,181
2030-2034 .....	195,607	26,383	221,990	114,458
2035-2039 .....	34,447	—	34,447	36,895
2040-2044 .....	—	—	—	22,465
2045-2049 .....	—	—	—	4,495
<b>Total minimum lease payments .....</b>	<b>1,136,984</b>	<b>368,918</b>	<b>1,505,902</b>	<b>605,377</b>
Less: unearned income .....	467,486	86,347	553,833	235,020
<b>Net investment in direct financing leases .....</b>	<b>669,498</b>	<b>282,571</b>	<b>952,069</b>	<b>370,357</b>
Less: current portion .....	52,638	48,191	100,829	11,442
<b>Noncurrent net investment in direct financing leases ..</b>	<b>\$ 616,860</b>	<b>\$ 234,380</b>	<b>\$ 851,240</b>	<b>\$ 358,915</b>

**NOTE 7: CAPITAL ASSETS**

Table 7 summarizes the capital activity for the primary government.

**Table 7****Schedule of Changes in Capital Assets – Primary Government**

June 30, 2014

(amounts in thousands)

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deductions</b>	<b>Ending Balance</b>
<b>Governmental activities</b>				
<b>Capital assets not being depreciated/amortized</b>				
Land .....	\$ 17,871,142 *	\$ 498,492	\$ 111,239	\$ 18,258,395
State highway infrastructure .....	64,183,838 *	1,213,741	128,893	65,268,686
Collections .....	22,645	—	15	22,630
Construction in progress .....	14,053,023 *	3,680,687	2,875,936	14,857,774
Intangible assets .....	1,106,355 *	377,103	17,051	1,466,407
<b>Total capital assets not being depreciated/amortized .....</b>	<b>97,237,003</b>	<b>5,770,023</b>	<b>3,133,134</b>	<b>99,873,892</b>
<b>Capital assets being depreciated/amortized</b>				
Buildings and improvements .....	20,448,490 *	1,626,299	16,820	22,057,969
Infrastructure .....	738,492	532	3,312	735,712
Equipment and other assets .....	4,654,507 *	372,011	266,336	4,760,182
Intangible assets .....	992,911 *	104,748	6,689	1,090,970
<b>Total capital assets being depreciated/amortized .....</b>	<b>26,834,400</b>	<b>2,103,590</b>	<b>293,157</b>	<b>28,644,833</b>
<b>Less accumulated depreciation/amortization for:</b>				
Buildings and improvements .....	6,841,635 *	538,495	10,287	7,369,843
Infrastructure .....	325,336	19,510	2,244	342,602
Equipment and other assets .....	3,903,250 *	307,322	247,150	3,963,422
Intangible assets .....	396,561 *	83,013	5,431	474,143
<b>Total accumulated depreciation/amortization .....</b>	<b>11,466,782</b>	<b>948,340</b>	<b>265,112</b>	<b>12,150,010</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>15,367,618</b>	<b>1,155,250</b>	<b>28,045</b>	<b>16,494,823</b>
<b>Governmental activities, capital assets, net .....</b>	<b>\$ 112,604,621</b>	<b>\$ 6,925,273</b>	<b>\$ 3,161,179</b>	<b>\$ 116,368,715</b>
<b>Business-type activities</b>				
<b>Capital assets not being depreciated/amortized</b>				
Land .....	\$ 216,888	\$ 5,395	\$ 145	\$ 222,138
Collections .....	6,051	1,680	20	7,711
Construction in progress .....	885,919 *	483,767	605,621	764,065
Intangible assets .....	403,979	16,596	171,974	248,601
<b>Total capital assets not being depreciated/amortized .....</b>	<b>1,512,837</b>	<b>507,438</b>	<b>777,760</b>	<b>1,242,515</b>
<b>Capital assets being depreciated/amortized</b>				
Buildings and improvements .....	10,451,931	838,891	465,750	10,825,072
Infrastructure .....	236,149	28,554	2,706	261,997
Equipment and other assets .....	576,331	88,915	14,117	651,129
Intangible assets .....	174,195 *	163,074	1,218	336,051
<b>Total capital assets being depreciated/amortized .....</b>	<b>11,438,606</b>	<b>1,119,434</b>	<b>483,791</b>	<b>12,074,249</b>
<b>Less accumulated depreciation/amortization for:</b>				
Buildings and improvements .....	4,164,763	256,776	440,014	3,981,525
Infrastructure .....	61,446	12,145	1,937	71,654
Equipment and other assets .....	347,815	53,901	11,194	390,522
Intangible assets .....	119,035	19,234	621	137,648
<b>Total accumulated depreciation/amortization .....</b>	<b>4,693,059</b>	<b>342,056</b>	<b>453,766</b>	<b>4,581,349</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>6,745,547</b>	<b>777,378</b>	<b>30,025</b>	<b>7,492,900</b>
<b>Business-type activities, capital assets, net .....</b>	<b>\$ 8,258,384</b>	<b>\$ 1,284,816</b>	<b>\$ 807,785</b>	<b>\$ 8,735,415</b>

\* Restated

Table 8 summarizes the depreciation expense charged to the activities of the primary government.

**Table 8**

**Schedule of Depreciation Expense – Primary Government**

June 30, 2014

(amounts in thousands)

	<b>Amount</b>
<b>Governmental activities</b>	
General government .....	\$ 130,960
Education .....	173,453
Health and human services .....	74,771
Resources .....	51,767
State and consumer services .....	66,722
Business and transportation .....	182,251
Correctional programs .....	220,513
Internal service funds (charged to the activities that utilize the fund) .....	47,903
<b>Total governmental activities .....</b>	<b>948,340</b>
<b>Business-type activities .....</b>	<b>342,056</b>
<b>Total primary government .....</b>	<b>\$ 1,290,396</b>

Table 9 summarizes the capital activity for discretely presented component units.

**Table 9**

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

June 30, 2014

(amounts in thousands)

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deductions</b>	<b>Ending Balance</b>
<b>Capital assets not being depreciated/amortized</b>				
Land .....	\$ 986,996 *	\$ 28,058	\$ 12,533	\$ 1,002,521
Collections .....	362,373	28,441	136	390,678
Construction in progress .....	2,991,757 *	803,485	133,720	3,661,522
Intangible assets .....	5,131	—	49	5,082
<b>Total capital assets not being depreciated/amortized .....</b>	<b>4,346,257</b>	<b>859,984</b>	<b>146,438</b>	<b>5,059,803</b>
<b>Capital assets being depreciated/amortized</b>				
Buildings and improvements .....	31,251,445 *	1,578,315	46,088	32,783,672
Infrastructure .....	666,799	18,349	62	685,086
Equipment and other depreciable assets .....	9,822,467 *	566,709	358,044	10,031,132
Intangible assets .....	674,542	210,312	48,883	835,971
<b>Total capital assets being depreciated/amortized .....</b>	<b>42,415,253</b>	<b>2,373,685</b>	<b>453,077</b>	<b>44,335,861</b>
<b>Less accumulated depreciation/amortization for:</b>				
Buildings and improvements .....	11,724,481 *	1,153,760	17,902	12,860,339
Infrastructure .....	305,908	23,211	22	329,097
Equipment and other depreciable assets .....	6,807,869 *	612,565	358,877	7,061,557
Intangible assets .....	299,981	24,876	33,094	291,763
<b>Total accumulated depreciation/amortization .....</b>	<b>19,138,239</b>	<b>1,814,412</b>	<b>409,895</b>	<b>20,542,756</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>23,277,014</b>	<b>559,273</b>	<b>43,182</b>	<b>23,793,105</b>
<b>Capital assets, net .....</b>	<b>\$ 27,623,271</b>	<b>\$ 1,419,257</b>	<b>\$ 189,620</b>	<b>\$ 28,852,908</b>

\* Restated



**NOTE 8: ACCOUNTS PAYABLE**

Accounts payable are amounts, related to different programs, that are due taxpayers, vendors, customers, beneficiaries, and employees. Table 10 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 10****Schedule of Accounts Payable**

June 30, 2014

(amounts in thousands)

	Education	Health and Human Services	Resources
<b>Governmental activities</b>			
General Fund .....	\$ 196,859	\$ 547,660	\$ 205,604
Federal Fund .....	31,065	331,696	61,154
Transportation Fund .....	—	4	3,961
Environmental and Natural Resources Fund .....	500	1,101	349,490
Nonmajor governmental funds .....	26,285	301,260	20,287
Internal service funds .....	11	—	19,497
Adjustment:			
Fiduciary funds .....	5,911,355	14,646,519	—
<b>Total governmental activities .....</b>	<b>\$ 6,166,075</b>	<b>\$ 15,828,240</b>	<b>\$ 659,993</b>
<b>Business-type activities</b>			
Electric Power Fund .....	\$ —	\$ —	\$ 6,000
Water Resources Fund .....	—	—	78,158
State Lottery Fund .....	—	—	—
Unemployment Programs Fund .....	—	19	—
California State University .....	173,638	—	—
Nonmajor enterprise funds .....	—	88	—
Adjustment:			
Fiduciary funds .....	—	—	—
<b>Total business-type activities .....</b>	<b>\$ 173,638</b>	<b>\$ 107</b>	<b>\$ 84,158</b>

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<b>Business and Transportation</b>	<b>General Government and Others</b>	<b>Total</b>
\$ 628	\$ 407,582	\$ 1,358,333
260,963	123,443	808,321
367,506	49,959	421,430
—	7,645	358,736
6,441	580,509	934,782
—	483,689	503,197
54,684	734,615	21,347,173
<b>\$ 690,222</b>	<b>\$ 2,387,442</b>	<b>\$ 25,731,972</b>
\$ —	\$ —	\$ 6,000
—	—	78,158
—	52,691	52,691
—	—	19
—	—	173,638
—	2,549	2,637
—	17	17
<b>\$ —</b>	<b>\$ 55,257</b>	<b>\$ 313,160</b>

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## 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.

There were no outstanding RANs at the beginning of the fiscal year. To fund cash flow needs for fiscal year 2013-14, the State issued \$5.5 billion in RANs on August 15, 2013. The RANs were repaid during May and June of 2014.

## NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2014, the primary government had long-term obligations totaling \$168.8 billion. Of that amount, \$7.7 billion is due within one year. For governmental activities, the beginning balance of revenue bonds increased \$11.8 billion and the beginning balance of capital lease obligations decreased \$5.1 billion as a result of the reclassification of the Public Buildings Construction Fund from an enterprise fund (business-type activity) to an internal service fund (governmental activity). This reclassification resulted in the elimination of the capital lease obligation of the governmental funds to the Public Buildings Construction Fund in the government-wide Statement of Net Position. After these beginning balance restatements, the largest changes in long-term obligations for governmental activities are an increase of \$3.1 billion in net other postemployment benefits obligation and an increase of \$1.1 billion in state-mandated cost claims payable. Another notable increase occurred in general obligation bonds payable. Notable decreases occurred in revenue bonds payable and compensated absences payable.

Not included in the mandated cost claims payable shown in Table 11 are certain state-mandated programs that are in the adjudication process. Until the Commission on State Mandates 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.

As of June 30, 2014, the pollution remediation obligations increased by \$73 million to \$1.1 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, 2014, the State estimates that remediation costs at Stringfellow will total \$385 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. 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, as required by state law.

The other long-term obligations for governmental activities consist of \$43 million owed for lawsuits, the University of California unfunded pension liability of \$24 million, and the Technology Services Revolving Fund notes payable of \$36 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 \$952 million for loans payable to the U.S. Department of Labor to cover shortfalls in the Unemployment Programs Fund and a decrease of \$812 million in revenue bonds payable (after the previously discussed restatement of the beginning balance for the reclassification of the Public Buildings Construction Fund from an enterprise fund to an internal service fund).

Table 11 summarizes the changes in long-term obligations during the year ended June 30, 2014.

**Table 11****Schedule of Changes in Long-term Obligations**

(amounts in thousands)

	<b>Balance July 1, 2013</b>	<b>Additions</b>
<b>Governmental activities</b>		
Compensated absences payable .....	\$ 4,135,101	\$ 1,290,940
Workers' compensation benefits payable .....	3,507,477	639,244
Certificates of participation and commercial paper outstanding .....	538,715	1,254,265
Discounts .....	(122)	—
Total certificates of participation and commercial paper payable .....	538,593	1,254,265
Capital lease obligations .....	236,305 *	80,022
General obligation bonds outstanding .....	79,688,445	5,905,370
Premiums .....	2,657,766	505,026
Total general obligation bonds payable .....	82,346,211	6,410,396
Revenue bonds outstanding .....	18,590,437 *	2,293,720
Accreted interest .....	383,862	40,564
Premiums .....	519,230	184,986
Discounts .....	(2,003)	—
Total revenue bonds payable .....	19,491,526	2,519,270
Mandated cost claims payable .....	6,750,849	1,154,062
Net other postemployment benefits obligation .....	15,559,232	4,871,902
Net pension obligation .....	3,278,774	207,749
Other long-term obligations:		
Proposition 98 funding guarantee .....	1,914,064	17,523
Pollution remediation obligations .....	1,009,216	151,527
Other .....	140,198	22,132
Total other long-term obligations .....	3,063,478	191,182
<b>Total governmental activities .....</b>	<b>\$ 138,907,546</b>	<b>\$ 18,619,032</b>
<b>Business-type activities</b>		
Loans payable .....	\$ 8,585,318	\$ —
Lottery prizes and annuities .....	1,198,904	3,624,432
Compensated absences payable .....	314,133	98,069
Workers' compensation benefits payable .....	2,078	460
Certificates of participation and commercial paper outstanding .....	77,560	262,036
Capital lease obligations .....	1,145,637	177,398
General obligation bonds outstanding .....	888,280	—
Discounts .....	(1,227)	—
Total general obligation bonds payable .....	887,053	—
Revenue bonds outstanding .....	13,080,438 *	470,300
Premiums .....	721,576	60,851
Discounts .....	(358)	—
Total revenue bonds payable .....	13,801,656	531,151
Net other postemployment benefits obligation .....	510,229	187,723
Other long-term obligations .....	482,571	37,540
<b>Total business-type activities .....</b>	<b>\$ 27,005,139</b>	<b>\$ 4,918,809</b>

\* Restated

<b>Deductions</b>	<b>Balance June 30, 2014</b>	<b>Due Within One Year</b>	<b>Noncurrent Liabilities</b>
\$ 1,670,152	\$ 3,755,889	\$ 5,346	\$ 3,750,543
445,289	3,701,432	410,534	3,290,898
1,194,810	598,170	8,565	589,605
(46)	(76)	(46)	(30)
1,194,764	598,094	8,519	589,575
56,239	260,088	59,896	200,192
5,297,945	80,295,870	3,827,670	76,468,200
182,315	2,980,477	161,390	2,819,087
5,480,260	83,276,347	3,989,060	79,287,287
2,945,896	17,938,261	580,591	17,357,670
—	424,426	—	424,426
147,748	556,468	66,666	489,802
(291)	(1,712)	(292)	(1,420)
3,093,353	18,917,443	646,965	18,270,478
54,259	7,850,652	135,473	7,715,179
1,814,275	18,616,859	—	18,616,859
248,738	3,237,785	—	3,237,785
2,505	1,929,082	409,614	1,519,468
78,777	1,081,966	81,055	1,000,911
59,431	102,899	60,645	42,254
140,713	3,113,947	551,314	2,562,633
<b>\$ 14,198,042</b>	<b>\$ 143,328,536</b>	<b>\$ 5,807,107</b>	<b>\$ 137,521,429</b>
\$ 951,927	\$ 7,633,391	\$ —	\$ 7,633,391
3,588,896	1,234,440	551,260	683,180
90,856	321,346	138,487	182,859
—	2,538	—	2,538
134,949	204,647	153,541	51,106
72,761	1,250,274	70,042	1,180,232
212,800	675,480	56,875	618,605
61	(1,288)	—	(1,288)
212,861	674,192	56,875	617,317
1,216,405	12,334,333	842,670	11,491,663
124,717	657,710	77,339	580,371
1,769	(2,127)	—	(2,127)
1,342,891	12,989,916	920,009	12,069,907
69,530	628,422	—	628,422
21,918	498,193	40,685	457,508
<b>\$ 6,486,589</b>	<b>\$ 25,437,359</b>	<b>\$ 1,930,899</b>	<b>\$ 23,506,460</b>

**NOTE 11: CERTIFICATES OF PARTICIPATION**

Table 12 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 12****Schedule of Debt Service Requirements for Certificates of Participation – Primary Government**

(amounts in thousands)

<b>Year Ending June 30</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2015 .....	\$ 8,565	\$ 1,075	\$ 9,640
2016 .....	11,915	625	12,540
<b>Total .....</b>	<b>\$ 20,480</b>	<b>\$ 1,700</b>	<b>\$ 22,180</b>

**NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS**

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program and an enterprise fund commercial paper program for the Department of Water Resources. Under the general obligation and enterprise fund programs, commercial paper (new issuance or rollover notes) may be issued at the prevailing market rate, not to exceed 11%, for periods not to exceed 270 days from the date of issuance. The proceeds from the initial issuance of commercial paper are restricted primarily for construction costs of general obligation bond program projects and certain state water projects. For both commercial paper borrowing programs, the commercial paper is retired by the issuance of long-term debt, so commercial paper is considered a noncurrent liability.

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The “Letter of Credit” agreements for the general obligation commercial paper program authorize the issuance of notes in an aggregate principal amount not to exceed \$1.7 billion. As of June 30, 2014, the general obligation commercial paper program had \$578 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, 2014, the enterprise fund commercial paper program had \$36 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, 2014, \$169 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 billion commercial paper program with tax-exempt and taxable components. At June 30, 2014, outstanding taxable commercial paper totaled \$994 million. 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 total \$262 million for general corporate purposes for the period ending June 30, 2014. For more information regarding the commercial paper program and other long-term borrowings of the University, refer to its separately issued financial report for fiscal year 2013-14 on its website at [www.ucop.edu](http://www.ucop.edu).

**NOTE 13: LEASES**

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2014, was approximately \$3.1 billion. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as being incurred over the lease term. Operating lease expenditures for the year ended June 30, 2014, amounted to approximately \$298 million for governmental activities and \$29 million for business-type activities. 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 net minimum capital lease payments for the primary government is \$1.5 billion. Note 10, Long-term Obligations, reports current additions and deductions for these capital lease obligations. Included in the capital lease commitments are lease-purchase agreements, amounting to a present value of net minimum lease payments of \$1.1 billion that the California State University, reported as an enterprise fund, has entered into with the State Public Works Board (SPWB), reported as an internal service fund. This amount represents 74.9% of the total present value of minimum capital lease payments of the primary government. Also included in the capital lease commitments are lease-purchase agreements to acquire equipment. Total assets related to capital leases have a net carrying value of \$432 million for governmental activities and \$808 million for business-type activities.

The capital lease commitments do not include \$6.0 billion in lease-purchase agreements with the SPWB and \$271 million in lease purchase agreements with building authorities that are blended component units. The SPWB and the 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 as governmental activities in the government-wide financial statements. Accordingly, the lease receivables and capital lease obligations associated with these buildings are not included in the government-wide financial statements.

The University of California, a discretely presented component unit, leases land, buildings, and equipment under agreements recorded as operating leases. Additional disclosure for the University's lease obligations is included in its separately issued financial statements that can be obtained from the University on its website at [www.ucop.edu](http://www.ucop.edu).



Table 13 summarizes future minimum lease commitments of the primary government.

**Table 13****Schedule of Future Minimum Lease Commitments – Primary Government**

(amounts in thousands)

Year Ending June 30	Governmental Activities		Business-type Activities		Total
	Operating Leases	Capital Leases	Operating Leases	Capital Leases	
2015 .....	\$ 239,809	\$ 65,304	\$ 25,216	\$ 132,459	\$ 462,788
2016 .....	175,419	51,409	18,949	132,086	377,863
2017 .....	124,533	39,989	17,861	127,679	310,062
2018 .....	60,848	29,047	14,598	127,196	231,689
2019 .....	29,916	26,019	11,107	103,219	170,261
2020-2024 .....	46,904	53,337	32,165	439,038	571,444
2025-2029 .....	23,990	4,369	16,373	385,756	430,488
2030-2034 .....	18,555	4,531	9,941	347,503	380,530
2035-2039 .....	101	3,833	3,031	149,000	155,965
2040-2044 .....	101	1,519	968	4,775	7,363
2045-2049 .....	101	—	397	—	498
2050-2054 .....	101	—	178	—	279
2055-2059 .....	74	—	32	—	106
2060-2064 .....	5	—	32	—	37
2065-2069 .....	—	—	32	—	32
2070-2074 .....	—	—	32	—	32
2075-2079 .....	—	—	32	—	32
2080-2084 .....	—	—	32	—	32
2085-2089 .....	—	—	32	—	32
2090-2094 .....	—	—	32	—	32
2095-2099 .....	—	—	33	—	33
<b>Total minimum lease payments .....</b>	<b>\$ 720,457</b>	<b>279,357</b>	<b>\$ 151,073</b>	<b>1,948,711</b>	<b>\$ 3,099,598</b>
Less: amount representing interest .....		19,269		698,437	
<b>Present value of net minimum lease payments .....</b>		<b>260,088</b>		<b>1,250,274</b>	
Less: current portion .....		59,896		70,042	
<b>Capital lease obligation, net of current portion .....</b>		<b>\$ 200,192</b>		<b>\$ 1,180,232</b>	

**NOTE 14: COMMITMENTS**

As of June 30, 2014, the primary government had commitments of \$7.7 billion for certain highway construction and high-speed rail projects. These commitments are not included as a liability in the Federal Fund or the Transportation Fund because future expenditures related to these commitments will be reimbursed with \$1.0 billion from local governments and \$6.7 billion from proceeds of approved federal grants. The primary government also had other commitments for which the future expenditures will be reimbursed by the proceeds of approved federal grants of \$569 million for various education programs, \$382 million for terrorism prevention and disaster-preparedness response projects, \$286 million for services under the workforce development program, \$160 million for services provided under various public health programs, \$152 million for community service programs, \$69 million for services provided under the welfare program, \$30 million for services provided under the rehabilitation program, and \$22 million for services provided under the child support program.

The primary government had other commitments, totaling \$8.6 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Position. The \$8.6 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 \$8.6 billion in commitments includes \$260 million in undisbursed loan commitments for various programs aimed at providing housing and emergency shelter to persons in need and \$1.0 billion for undisbursed loan commitments to qualified agencies for clean water projects. In addition, the \$8.6 billion in commitments includes \$73 million in long-term contracts to purchase power. These contracts qualify for the Normal Purchase Normal Sale exception under GASB Statement No. 53 and, therefore, are not included on the Statement of Net Position of the Electric Power Fund nor disclosed as derivative financial instruments.

The \$8.6 billion in commitments also includes contracts of \$958 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. The primary government had commitments of \$265 million for California State University (CSU) construction projects. CSU participates in forward-purchase contracts of natural gas and electricity. As of June 30, 2014, CSU's obligation under these special purchase arrangements requires it to purchase at fixed prices an estimated total of \$21 million in electricity through December 2015 and \$23 million in natural gas through June 2017. The primary government also had commitments of \$18 million to veterans for the purchase of properties under contracts of sale. The California State Lottery Commission had commitments of \$438 million for gaming and telecommunication systems and services. These are long-term projects, and all of the contracts' needs may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

As of June 30, 2014, the primary government encumbered expenditures of \$784 million for the General Fund, \$3.1 billion for the Transportation Fund, \$1.1 billion for the Environmental and Natural Resources Fund, and \$658 million for the nonmajor governmental funds. See Note 2A, Budgeting and Budgetary Control, for an explanation of the primary government's policy concerning encumbrances.

As of June 30, 2014, the discretely presented and fiduciary component units had other commitments that were not included as liabilities on the corresponding Statement of Net Position. Additional disclosure for the University of California's commitments is included in its separately issued financial statements, which can be obtained from the University on its website at [www.ucop.edu](http://www.ucop.edu). Additional disclosure for the California Housing Finance Agency's (CalHFA) commitments is included in its separately issued financial statements, which can be obtained from the CalHFA on its website at [www.CalHFA.ca.gov](http://www.CalHFA.ca.gov). Additional disclosure for the California Public Employees' Retirement System's (CalPERS) commitments is included in its separately issued financial statements, which can be obtained from CalPERS on its website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

## 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, 2014, the State had \$80.3 billion in outstanding general obligation bonds related to governmental activities and \$675 million related to business-type activities. In addition, \$26.5 billion of long-term general obligation bonds had been authorized but not issued, of which \$25.8 billion is related to governmental activities and \$706 million is related to business-type activities. The total amount authorized but not issued includes \$17 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, \$578 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, 2014, the State had \$3.0 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 \$498 million in weekly or monthly rate bonds without credit enhancement. During fiscal year 2013-14, the State issued \$300 million of variable-rate general obligation 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 Index Floating Rate Bonds are determined by the Securities Industry and Financial Markets Association (SIFMA) Index rate or percentage of the London Interbank Offered Rate (LIBOR) then in effect plus a pre-determined spread. 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 that 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 2013-14.

The letters of credit for the Series 2003 variable-rate bonds have expiration dates of October 16, 2015; November 10, 2016; December 16, 2016; and April 12, 2017. The letters of credit for the Series 2004 variable-rate bonds have expiration dates of April 6, 2015; October 15, 2015; and November 10, 2016. The letters of credit for the Series 2005 variable-rate bonds have expiration dates of November 4, 2016; November 10, 2016; December 16, 2016; February 17, 2017; and April 11, 2017. The Series 2012A and 2013 C, D and E Index Floating Rate Bonds have mandatory purchase dates on May 1, 2015, December 1, 2016, December 1, 2017, or December 3, 2018. The Series 2012B SIFMA Index Floating Rate Bonds have final maturities from 2017 to 2020.

Based on the schedules provided in the Official Statements, any required 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: 2015-16 through 2033-34, and 2039-40. 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, 2014, the State had \$4.6 billion in Economic Recovery Bonds outstanding. Of the \$4.6 billion outstanding, bonds totaling \$110 million are variable-rate bonds in the daily-rate mode and \$500 million are mandatory tender bonds. The interest rates associated with the daily-rate bonds are determined by the remarketing agent 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 a letter of credit. The State reimburses the credit provider for any amounts paid. The expiration date for the letter of credit is December 12, 2014.

## **C. Mandatory Tender Bonds**

Of the \$4.6 billion in outstanding Economic Recovery Bonds, \$500 million were mandatory tender bonds and had an interest rate reset date of July 1, 2014. On that date, the bonds became 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 could have remarketed or redeemed these bonds. The State redeemed these bonds on July 1, 2014. The debt service requirements in Table 14 include the effect of this redemption in fiscal year ended June 30, 2015.

As of June 30, 2014, the State had \$850 million in outstanding general obligation mandatory tender bonds, including \$450 million with a fixed interest rate and \$400 million with an index floating rate (discussed in Section A). On their respective mandatory tender dates, these bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium, unless the bonds have been called for redemption on or prior to that day. These bonds have mandatory tender dates on May 1, 2015; December 1, 2016; December 1, 2017; and December 3, 2018. In the event of an unsuccessful remarketing of all the outstanding bonds on the scheduled mandatory tender dates, the bonds will enter into a

delayed remarketing period and accrue interest at a higher effective interest rate, gradually increasing on a stepped basis until they are remarketed, redeemed, or paid at maturity. Current state laws limit interest rates to 11% per annum. With respect to \$100 million of the Index Floating Rate Bonds, beginning six months after the scheduled mandatory tender date, the bonds will be subject to special mandatory redemption in 20 equal quarterly installments until they are remarketed or refunded.

## D. Build America Bonds

As of June 30, 2014, 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 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. Subsequent federal legislation reduced the Build America Bonds subsidy by 8.7% for the federal fiscal year ending September 30, 2013 and 7.2% for the federal fiscal year ending September 30, 2014. The cash payment does not constitute a full faith and credit guarantee of the federal government, but is required to be paid by the United States Treasury under ARRA. The subsidy payments are deposited into the state treasury.

## E. Debt Service Requirements

Table 14 shows the debt service requirements for all general obligation bonds as of June 30, 2014. The estimated debt service requirements for the \$3 billion variable-rate general obligation bonds and the \$110 million variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2014. For mandatory tender bonds, the debt service requirements shown in Table 14 are based on the assumption that the interest rate will remain in effect until the applicable reset dates and that the bonds will be fully redeemed on their scheduled maturity dates. 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 14**

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

(amounts in thousands)

Year Ending June 30	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2015.....	\$ 3,827,670	\$ 4,117,916	\$ 7,945,586	\$ 56,875	\$ 29,345	\$ 86,220
2016.....	3,174,350	3,962,830	7,137,180	75,620	26,610	102,230
2017.....	2,759,560	3,829,238	6,588,798	61,895	23,909	85,804
2018.....	2,741,100	3,709,530	6,450,630	39,600	21,708	61,308
2019.....	3,323,295	3,574,474	6,897,769	26,800	20,220	47,020
2020 - 2024.....	14,025,615	15,563,258	29,588,873	75,475	85,212	160,687
2025 - 2029.....	12,781,005	12,597,373	25,378,378	55,265	74,625	129,890
2030 - 2034.....	14,788,660	9,438,265	24,226,925	157,965	45,129	203,094
2035 - 2039.....	15,559,405	5,130,596	20,690,001	91,605	17,834	109,439
2040 - 2044.....	7,315,210	942,934	8,258,144	34,380	1,600	35,980
<b>Total .....</b>	<b>\$ 80,295,870</b>	<b>\$ 62,866,414</b>	<b>\$ 143,162,284</b>	<b>\$ 675,480</b>	<b>\$ 346,192</b>	<b>\$ 1,021,672</b>

## F. General Obligation Bond Defeasances

### 1. Current Year

On September 10, 2013, the primary government issued \$559 million in general obligation bonds to current refund \$586 million of outstanding general obligation bonds maturing in 2015 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 \$80 million and resulted in an economic gain of \$56 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.09% per year over the life of the new bonds.

On November 5, 2013, the primary government issued \$723 million in general obligation bonds to current refund \$782 million of outstanding general obligation bonds maturing in 2015 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 \$122 million and resulted in an economic gain of \$87 million, discounted at 3.90% per year over the life of the new bonds.

On March 27, 2014, the primary government issued \$795 million in general obligation bonds to current and advance refund \$880 million of outstanding general obligation bonds maturing in 2014 to 2034. 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 \$161 million and resulted in an economic gain of \$117 million, discounted at 3.43% 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, 2014, the outstanding balance of general obligation bonds defeased in prior years was approximately \$325 million.

## 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 \$141 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 finance 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, as authorized by state law, has issued asset-backed bonds to purchase 100% of 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 \$18.4 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 \$377 million, while Tobacco Settlement Revenue and interest earned totaled \$356 million. These bonds are included in the governmental activities column of the government-wide Statement of Net Position.

Under state law, State Public Works Board (SPWB), an agency that accounts for its activity in the Public Buildings Construction Fund, an internal service fund, and 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 Public Buildings Construction Fund and building authorities. The General Fund 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, financing of electric power purchases for resale to utility customers, state university campuses, 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. For more information regarding revenue bonds, current year defeasances, and outstanding defeasances of the University, refer to its separately issued financial report for fiscal year 2013-14 on its website at [www.ucop.edu](http://www.ucop.edu).

Under state law, the California Housing Finance Agency (CalHFA) issues fixed-rate 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 Securities Industry and Financial Markets Association (SIFMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically. CalHFA issues both federally taxable and tax-exempt bonds. The bonds issued by CalHFA are payable solely from and collateralized by revenues and other pledged assets. For more information regarding revenue bonds, current year defeasances, and outstanding defeasances of the CalHFA, refer to its separately issued financial report for fiscal year 2013-14 on its website at [www.CalHFA.ca.gov](http://www.CalHFA.ca.gov).

Table 15 shows outstanding revenue bonds of the primary government and the discretely presented component units.

**Table 15****Schedule of Revenue Bonds Payable**

June 30, 2014

(amounts in thousands)

**Primary government****Governmental activities**

Transportation Fund .....	\$ 137,659
Public Buildings Construction Fund .....	11,323,687
Nonmajor governmental funds:	
Golden State Tobacco Securitization Corporation Fund .....	7,167,103
Building authorities .....	288,994

<b>Total governmental activities .....</b>	<b>18,917,443</b>
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**Business-type activities**

Electric Power Fund .....	6,249,000
Water Resources Fund .....	2,647,814
California State University .....	3,663,116
Nonmajor enterprise funds .....	429,986

<b>Total business-type activities .....</b>	<b>12,989,916</b>
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<b>Total primary government .....</b>	<b>31,907,359</b>
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**Discretely presented component units**

University of California .....	16,561,052
California Housing Finance Agency .....	3,596,347
Nonmajor component units .....	246,756

<b>Total discretely presented component units .....</b>	<b>20,404,155</b>
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<b>Total revenue bonds payable .....</b>	<b>\$ 52,311,514</b>
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Table 16 shows the debt service requirements for fixed-rate and variable-rate bonds. It excludes unamortized premiums and discounts that are included in Table 15.

**Table 16**

**Schedule of Debt Service Requirements for Revenue Bonds**

(amounts in thousands)

Year Ending June 30	Primary Government				Discretely Presented	
	Governmental Activities		Business-type Activities		Component Units	
	Principal	Interest	Principal	Interest	Principal	Interest *
2015 .....	\$ 580,591	\$ 894,061	\$ 842,670	\$ 581,159	\$ 388,475	\$ 909,744
2016 .....	545,951	870,953	922,715	543,053	452,003	881,647
2017 .....	610,761	844,555	951,265	501,123	449,336	859,986
2018 .....	649,146	813,396	985,515	456,399	435,674	838,259
2019 .....	628,196	776,337	1,015,355	410,747	441,415	817,289
2020-2024 .....	3,111,706	3,499,513	3,979,498	1,317,112	2,896,410	3,699,230
2025-2029 .....	3,136,099	2,920,227	1,564,505	704,171	3,040,940	2,921,805
2030-2034 .....	3,167,515	1,982,982	1,128,675	367,114	3,463,482	2,157,148
2035-2039 .....	2,592,035	1,156,841	722,470	137,853	3,342,858	1,357,680
2040-2044 .....	1,904,530	820,802	217,270	20,047	2,729,054	674,677
2045-2049 .....	1,436,157	3,507,027	4,395	98	1,187,130	321,722
2050-2112 .....	—	—	—	—	881,225	2,633,368
<b>Total .....</b>	<b>\$ 18,362,687</b>	<b>\$ 18,086,694</b>	<b>\$ 12,334,333</b>	<b>\$ 5,038,876</b>	<b>\$ 19,708,002</b>	<b>\$ 18,072,555</b>

\* Includes interest on variable-rate bonds based on rates in effect on June 30, 2014.

## D. Revenue Bond Defeasances

### 1. Current Year – Governmental Activities

In September 2013, the SPWB and the University of California entered into a series of restructuring agreements, in which bonds held by the SPWB for University projects were refunded by revenue bonds issued by the University. Additionally, on October 2, 2013, the SPWB entered into an escrow agreement with the State Treasurer. The cash transferred to the State Treasurer, along with deposits from the University from the refunding bonds, will be used to make principal and interest payments for the refunded debt, resulting in the legal defeasance of \$2.2 billion in bonds payable. The restructuring was authorized in the 2013-14 budget.

The SPWB and the University also executed termination agreements relating to all leases relating to the defeased and redeemed bonds. As a result, all the net investment in direct financing leases, construction work in progress, and bonds payable related to these leases were removed from the Public Buildings Construction Fund Statement of Net Position. The net effect of these transactions was a loss of \$55 million, as shown in the Public Buildings Construction Fund's Statement of Revenues, Expenses, and Changes in Fund Net Position.

## 2. Current Year – Business-type Activities

As discussed under governmental activities above, the restructuring agreement between the SPWB and the University and the escrow agreement between the SPWB and the State Treasurer resulted in the legal defeasance of all outstanding bonds reported in the High Technology Education Fund, a nonmajor enterprise fund. In addition, the related lease receivable was terminated and the High Technology Education Fund's remaining assets were transferred to the escrow account with the State Treasurer and the fund was dissolved. The net effect of the restructure and refunding was a loss of \$27 million, as shown in the enterprise funds' Combining Statement of Revenues, Expenses, and Changes in Fund Net Position.

In August 2013, California State University issued \$309 million in systemwide revenue refunding bonds to partially defease certain outstanding systemwide revenue bonds. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered defeased and the liability for these bonds has been removed from the financial statements. This refunding will decrease debt service payments by \$22 million over the life of the bonds and will result in an economic gain of \$19 million for the refunded bonds.

## 3. 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, 2014, the outstanding balance of revenue bonds defeased in prior years was \$632 million for business-type activities. All previously defeased revenue bonds for governmental activities were redeemed by June 30, 2014.

## NOTE 17: SERVICE CONCESSION ARRANGEMENTS

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. The amount of the primary government's service concession arrangements can be found in Note 21, Deferred Outflows and Deferred Inflows of Resources.

The University of California, a discretely presented component unit, has entered into service concession arrangements with third parties for student housing and certain other faculty and student services. Payments received or to be received by the University from service concession arrangements are reported as deferred inflows of resources. Additional information on the University's service concession arrangements can be found in the University's separately issued financial statements on its website at [www.ucop.edu](http://www.ucop.edu).

**NOTE 18: INTERFUND BALANCES AND TRANSFERS****A. Interfund Balances**

Short-term interfund receivables and payables result 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 17 shows the amounts due from and due to other funds.

**Table 17****Schedule of Due From Other Funds and Due To Other Funds**

June 30, 2014

(amounts in thousands)

Due From	Due To				
	General Fund	Transportation Fund	Environmental and Natural Resources Fund	Nonmajor Governmental Fund	Electric Power Fund
<b>Governmental funds</b>					
General Fund .....	\$ —	\$ —	\$ —	\$ 571,090	\$ —
Federal Fund .....	632,163	919,991	37,392	248,038	—
Transportation Fund .....	19,052	—	—	34,836	—
Environmental and Natural Resources Fund ....	21,278	6,476	—	5	—
Nonmajor governmental funds .....	768,555	30,274	7,836	18,272	—
<b>Total governmental funds .....</b>	<b>1,441,048</b>	<b>956,741</b>	<b>45,228</b>	<b>872,241</b>	<b>—</b>
<b>Enterprise funds</b>					
Water Resources Fund .....	—	—	—	—	—
State Lottery Fund .....	137	155	—	314,620	—
Unemployment Programs Fund .....	59,896	—	—	—	—
Nonmajor enterprise funds .....	1,107	—	151	208	—
<b>Total enterprise funds .....</b>	<b>61,140</b>	<b>155</b>	<b>151</b>	<b>314,828</b>	<b>—</b>
<b>Internal service funds .....</b>	<b>8,707</b>	<b>13,779</b>	<b>2,861</b>	<b>19,126</b>	<b>3,000</b>
<b>Total due from other funds .....</b>	<b>\$ 1,510,895</b>	<b>\$ 970,675</b>	<b>\$ 48,240</b>	<b>\$ 1,206,195</b>	<b>\$ 3,000</b>

Due To							
Water Resources Fund	State Lottery Fund	Unemployment Programs Fund	California State University Fund	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Total Due to Other Funds
\$ —	\$ —	\$ —	\$ 257	\$ —	\$ 285,469	\$ 8,416,873	\$ 9,273,689
—	—	36,689	—	169	10,870	10,952,460	12,837,772
—	—	—	—	—	12,660	54,090	120,638
—	—	—	—	21	19,349	109	47,238
—	—	—	382	75	17,424	1,923,001	2,765,819
—	—	<b>36,689</b>	<b>639</b>	<b>265</b>	<b>345,772</b>	<b>21,346,533</b>	<b>25,045,156</b>
—	—	—	—	—	47,681	—	47,681
—	—	—	—	—	—	—	314,912
—	—	—	—	—	—	—	59,896
—	—	—	—	—	69	17	1,552
—	—	—	—	—	<b>47,750</b>	<b>17</b>	<b>424,041</b>
<b>1,129</b>	<b>295</b>	<b>1,827</b>	<b>466</b>	<b>407</b>	<b>48,400</b>	<b>640</b>	<b>100,637</b>
<b>\$ 1,129</b>	<b>\$ 295</b>	<b>\$ 38,516</b>	<b>\$ 1,105</b>	<b>\$ 672</b>	<b>\$ 441,922</b>	<b>\$ 21,347,190</b>	<b>\$ 25,569,834</b>

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. In addition to the temporary interfund cash-flow borrowing shown in Table 17, annual enacted budgets provide for long-term loans from many of the State's special funds—mainly the Transportation Fund, Environmental and Natural Resources Fund, and nonmajor governmental funds—to the General Fund. The \$3.3 billion in Transportation Fund loans payable from the General Fund also includes \$1.0 billion in deferred Proposition 42 transfers for traffic congestion relief and other direct loans from the Traffic Congestion Relief Program.

Table 18 shows the primary government's interfund receivables and payables.

**Table 18**

**Schedule of Interfund Receivables and Payables**

June 30, 2014

(amounts in thousands)

Interfund Receivables	Interfund Payables		
	General Fund	Transportation Fund	Environmental and Natural Resources Funds
<b>Governmental funds</b>			
General Fund .....	\$ —	\$ 3,337,281	\$ 829,227
Transportation Fund .....	—	—	—
Environmental and Natural Resources Fund .....	—	25,000	—
Nonmajor governmental funds .....	8,584	—	—
<b>Total governmental funds .....</b>	<b>8,584</b>	<b>3,362,281</b>	<b>829,227</b>
<b>Internal service funds .....</b>	<b>40,650</b>	<b>—</b>	<b>—</b>
<b>Total primary government .....</b>	<b>\$ 49,234</b>	<b>\$ 3,362,281</b>	<b>\$ 829,227</b>

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**Interfund Payables**


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<b>Nonmajor Governmental Fund</b>	<b>Water Resources Fund</b>	<b>Unemployment Programs Fund</b>	<b>Nonmajor Enterprise Funds</b>	<b>Internal Service Funds</b>	<b>Total</b>
\$ 1,332,548	\$ —	\$ 611,690	\$ 5,600	\$ 7,191	\$ 6,123,537
—	—	—	—	2,316	2,316
—	—	—	—	—	25,000
—	—	—	—	—	8,584
<b>1,332,548</b>	<b>—</b>	<b>611,690</b>	<b>5,600</b>	<b>9,507</b>	<b>6,159,437</b>
<b>172</b>	<b>91,517</b>	<b>—</b>	<b>—</b>	<b>6,267</b>	<b>138,606</b>
<b>\$ 1,332,720</b>	<b>\$ 91,517</b>	<b>\$ 611,690</b>	<b>\$ 5,600</b>	<b>\$ 15,774</b>	<b>\$ 6,298,043</b>

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The amounts 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 19 shows the amounts due from the primary government and due to component units.

**Table 19**

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

June 30, 2014

(amounts in thousands)

	Due To		
	Component Units		
Due From	University of California	Nonmajor Component Units	Total
<b>Governmental funds</b>			
General Fund .....	\$ 205,129	\$ 1,212	\$ 206,341
<b>Total governmental funds .....</b>	<b>205,129</b>	<b>1,212</b>	<b>206,341</b>
<b>Total primary government .....</b>	<b>\$ 205,129</b>	<b>\$ 1,212</b>	<b>\$ 206,341</b>

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## 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 \$2.3 billion to the California State University, an enterprise fund. The General Fund also transferred \$1.6 billion to nonmajor governmental funds mainly for support of trial courts and state and local government health care programs. The Transportation Fund transferred \$1.0 billion of weight fee revenues to the Transportation Debt Service Fund, a nonmajor governmental fund, for reimbursement of debt service costs. The Federal Fund transferred \$631 million to the General Fund for administration of the Unemployment Insurance Program.

Table 20 shows interfund transfers of the primary government.

**Table 20**

**Schedule of Interfund Transfers**

June 30, 2014

(amounts in thousands)

Transferred From	Transferred To		
	General Fund	Transportation Fund	Environmental and Natural Resources Funds
<b>Governmental funds</b>			
General Fund .....	\$ —	\$ —	\$ 28,853
Federal Fund .....	631,194	—	173,568
Transportation Fund .....	74,430	—	12,903
Environmental and Natural Resources Fund .....	8,849	—	—
Nonmajor governmental funds .....	273,021	25	24,775
<b>Total governmental funds .....</b>	<b>987,494</b>	<b>25</b>	<b>240,099</b>
<b>Nonmajor enterprise funds .....</b>	<b>199</b>	<b>—</b>	<b>—</b>
<b>Internal service funds .....</b>	<b>8,766</b>	<b>—</b>	<b>—</b>
<b>Total primary government .....</b>	<b>\$ 996,459</b>	<b>\$ 25</b>	<b>\$ 240,099</b>

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Transferred To			
Nonmajor Governmental Funds	California State University Fund	Internal Service Funds	Total
\$ 1,577,442	\$ 2,302,858	\$ 6,394	\$ 3,915,547
17,970	—	—	822,732
1,071,822	—	—	1,159,155
13,814	—	—	22,663
86,129	—	—	383,950
<b>2,767,177</b>	<b>2,302,858</b>	<b>6,394</b>	<b>6,304,047</b>
—	—	<b>6,649</b>	<b>6,848</b>
<b>37,490</b>	—	<b>63,614</b>	<b>109,870</b>
<b>\$ 2,804,667</b>	<b>\$ 2,302,858</b>	<b>\$ 76,657</b>	<b>\$ 6,420,765</b>

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**NOTE 19: FUND BALANCES, FUND DEFICITS, AND ENDOWMENTS****A. Fund Balances**

Table 21 shows the composition of the governmental fund balances at June 30, 2014.

**Table 21****Schedule of Fund Balances by Function**

June 30, 2014

(amounts in thousands)

<b>Year Ending June 30</b>	<b>General Fund</b>	<b>Federal Fund</b>	<b>Transportation Fund</b>	<b>Environmental and Natural Resources Fund</b>	<b>Nonmajor Governmental Funds</b>
<b>Nonspendable</b>					
Long-term interfund receivables .....	\$ 49,234	\$ —	\$ —	\$ —	\$ —
Long-term loans receivable .....	79,375	—	—	—	—
Other .....	—	—	—	—	27,260
<b>Total nonspendable .....</b>	<b>128,609</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>27,260</b>
<b>Restricted</b>					
General government .....	6,113	—	—	14,222	3,639,099
Education .....	284,204	296	4,824	—	852,134
Health and human services .....	101,301	257	—	1,365,893	2,295,229
Resources .....	—	9,217	—	4,838,324	98,547
State and consumer services .....	2,628	—	224,207	55,432	518,981
Business and transportation .....	—	201,804	7,169,827	47,236	2,931,637
Correctional programs .....	—	—	—	—	1,927
<b>Total restricted .....</b>	<b>394,246</b>	<b>211,574</b>	<b>7,398,858</b>	<b>6,321,107</b>	<b>10,337,554</b>
<b>Committed</b>					
General government .....	13,999	—	—	21,623	334,549
Education .....	3,023	—	—	—	30,777
Health and human services .....	4,445	—	1,430	—	269,511
Resources .....	455	—	10	1,275,839	740,043
State and consumer services .....	—	—	—	23,649	57,697
Business and transportation .....	—	—	65,926	—	87,123
Correctional programs .....	103,198	—	—	—	6,570
<b>Total committed .....</b>	<b>125,120</b>	<b>—</b>	<b>67,366</b>	<b>1,321,111</b>	<b>1,526,270</b>
<b>Assigned – General government .....</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>18,857</b>
<b>Unassigned .....</b>	<b>(8,092,571)</b>	<b>—</b>	<b>—</b>	<b>(11,664)</b>	<b>(8,481)</b>
<b>Total fund balances (deficit) .....</b>	<b>\$ (7,444,596)</b>	<b>\$ 211,574</b>	<b>\$ 7,466,224</b>	<b>\$ 7,630,554</b>	<b>\$ 11,901,460</b>

## B. Fund Deficits

Table 22 shows the funds that had deficit balances at June 30, 2014.

**Table 22**

**Schedule of Fund Deficits**

June 30, 2014

(amounts in thousands)

	Governmental Funds	Internal Service Funds	Enterprise Funds
General Fund .....	\$ 7,444,596	\$ —	\$ —
Architecture Revolving Fund .....	—	26,660	—
Service Revolving Fund .....	—	172,160	—
Water Resources Fund .....	—	51,390	—
Unemployment Programs Fund .....	—	—	2,657,890
<b>Total fund deficits .....</b>	<b>\$ 7,444,596</b>	<b>\$ 250,210</b>	<b>\$ 2,657,890</b>

## C. Discretely Presented Component Unit Endowments and Gifts

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net position categories of the government-wide and fund financial statements. As of June 30, 2014, the total value of restricted endowments and gifts was \$14.2 billion and unrestricted endowments and gifts was \$2.1 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 \$2.1 billion at June 30, 2014. 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 \$946 million and \$9 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 \$3.7 billion as of June 30, 2014. 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 \$5.2 billion is discounted to \$3.7 billion using a 3.5% interest rate. Of the total, \$410 million is a current liability, of which \$273 million is included in the General Fund, \$134 million in the special revenue funds, and \$3 million in the internal service funds. The remaining \$3.3 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 23 shows the changes in the self-insurance claims liability for the primary government and the discretely presented component units.

**Table 23**

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

Year Ended June 30

(amounts in thousands)

	Primary Government		Discretely Presented Component Unit University of California	
	2014	2013	2014	2013
Unpaid claims, beginning .....	\$ 3,509,555	\$ 3,204,635	\$ 631,798	\$ 599,176
Incurred claims .....	639,704	754,641	467,191	421,832
Claim payments .....	(445,289)	(449,721)	(454,411)	(389,210)
<b>Unpaid claims, ending .....</b>	<b>\$ 3,703,970</b>	<b>\$ 3,509,555</b>	<b>\$ 644,578</b>	<b>\$ 631,798</b>

## NOTE 21: DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES

In the fund financial statements, governmental funds reported deferred inflows of resources of \$2.0 billion because this amount represents revenues that are earned and measurable, but not available within 12 months of the end of the reporting period.

Table 24 shows the detail of the deferred outflows of resources and deferred inflows of resources reported in the government-wide Statement of Net Position.

**Table 24**

### Schedule of Deferred Outflows and Deferred Inflows of Resources

June 30, 2014

(amounts in thousands)

	Primary Government			Component Units
	Governmental Activities	Business-Type Activities	Total	
<b>Deferred outflows of resources:</b>				
Loss on refunding of debt .....	\$ 986,477	\$ 242,167	\$ 1,228,644	\$ 346,480
Decrease in fair value of hedging derivatives .....	—	—	—	100,282
Net pension liability .....	—	—	—	3,290,476
<b>Total deferred outflows of resources .....</b>	<b>986,477</b>	<b>242,167</b>	<b>1,228,644</b>	<b>3,737,238</b>
<b>Deferred inflows of resources:</b>				
Gain on refunding of debt .....	106,426	—	106,426	1,561
Service concession arrangements .....	64,376	—	64,376	30,701
Net pension liability .....	—	—	—	7,077,861
Other deferred inflows .....	—	822,886	822,886	—
<b>Total deferred inflows of resources .....</b>	<b>\$ 170,802</b>	<b>\$ 822,886</b>	<b>\$ 993,688</b>	<b>\$ 7,110,123</b>

## 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 by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, 2014, these component units had approximately \$4.3 billion of debt outstanding, which is not debt of the State.

The conduit obligations outstanding for the California Housing Finance Agency, a major component unit, amounted to \$341 million, which is not debt of the State.

## 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, 2014; legal proceedings that were in progress as of June 30, 2014, and were settled or decided against the primary government as of March 19, 2015; and legal proceedings having a high probability of resulting in a decision against the primary government as of March 19, 2015, 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). Plaintiffs allege class action relief, declaratory relief, and seek attorney fees based on alleged violations to the state and federal constitutions. They seek certification of two classes of allegedly similarly situated LLCs and unspecified amount of refunds on behalf of the LLC classes, alleged to be in excess of 50,000 members. Briefing of the appeal was completed on December 17, 2014, and the parties are waiting for notice of oral argument.

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.

The primary government is a defendant in a case, *Harley-Davidson, Inc. and Subsidiaries v. Franchise Tax Board* 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. The plaintiff claims, among other things, that section 25101.15 unlawfully discriminates against them because it allows intrastate unitary businesses the option to report on either a separate or combined basis, and that they should be allowed to report the income of their business entities on a separate basis. The Franchise Tax Board prevailed in the trial court, and the case is fully briefed and awaiting oral argument on appeal. If section 25101.15 were invalidated, the dollar amount of potential refunds for past years is impossible to estimate, but could be substantial. The potential loss of future revenue is also impossible to estimate, but could be mitigated by legislative action.

The primary government is a defendant in another case, *Abercrombie & Fitch Co. & Subsidiaries v. Franchise Tax Board*, regarding constitutionality of Revenue and Taxation Code section 25101.15. The parties' cross-motions for summary judgment were heard on January 8, 2015. After that hearing, the superior court stayed further proceedings pending an appellate decision in the *Harley-Davidson* case. An estimate of potential loss is not possible.

The primary government is the defendant in a consolidated case, *The Gillette Company & Subsidiaries v. Franchise Tax Board*, formerly 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. Multistate taxpayers claim that amended Revenue and Taxation Code section 25128 is invalid because California failed to repeal the entire Multistate Tax Compact. The case is fully briefed and before the California Supreme Court awaiting a hearing date. Taxpayers seek a combined refund totaling approximately \$34 million (plus statutory interest) for taxable years 1993 through 2005. If amended section 25128 is found invalid, the potential total refunds to other taxpayers are impossible to estimate with precision, but could exceed \$750 million.

The primary government is the defendant in the following cases: *Anthem Blue Cross v. David Maxwell-Jolly, et al.*; *Molina Family Health Plan v. DHCS*; *Health Net of California, Inc. v. DHCS*; and *Santa Clara Family Health Plan v. David Maxwell-Jolly et al.* regarding application of budget reduction factors to managed-care capitated rates. These cases have been settled on a contingent basis based on the plans' profitability. The estimated combined potential total loss is more than \$400 million based on four separate settlement agreements that were entered into in 2013 and 2014.

## **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, California Housing Finance Agency (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, 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.

Both CalPERS and CalSTRS retirement systems implemented the GASB Statement No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*, in their fiscal year 2013-14 financial statements. The objective of GASB 67 is to improve financial reporting by state and local governmental pension plans and the decision-usefulness of reported pension information as well as to increase the transparency, consistency, and comparability of pension information across governments.

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. CalPERS 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 Public Employees' Retirement System on its website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

CalPERS uses the accrual basis of accounting. Contributions to the pension trust funds are recognized in the period in which the contributions are due pursuant to legal requirements. 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 on its website at [www.CalSTRS.com](http://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). The PERF is comprised of and reported as three separate entities for accounting purposes. PERF A is comprised of agent multiple-employer plans, which includes State of California and most public agencies' rate plans with more

than 100 active members. PERF B is a cost-sharing multiple-employer plan of school employers consisting of non-teaching and non-certified employees. PERF C is a cost-sharing multiple-employer plan of public agencies plans with generally less than 100 active members. Employers participating in the PERF include the primary government and certain discretely presented component units, 1,517 school employers, and 1,746 public agencies as of June 30, 2014.

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 \$36.4 billion at June 30, 2013, as a result of the difference between the actuarial value of assets of \$111.0 billion and the actuarial accrued liability of \$147.4 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 acts 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, 2013 actuarial valuation, the payroll for primary government employees covered by the PERF for the 2012-13 fiscal year was \$15.3 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 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 1.5% to 12.0% of their salaries over the base compensation amount.

All of the primary government employees served by the PERF are now covered by group term life insurance.

Table 25 shows the required employer contribution rates for the primary government.

**Table 25**

**Schedule of Required Employer Contribution Rates for the Primary Government – By Member Category**  
Year Ended June 30, 2014

	<b>Normal Cost</b>	<b>Unfunded Liability</b>	<b>Group Term Life Benefit</b>	<b>Total Rate</b>
Miscellaneous members				
First tier .....	8.089 %	12.961 %	0.071 %	21.121 %
Second tier .....	7.960	12.961	0.071	20.992
Industrial (first and second tier) .....	10.325	5.357	0.000	15.682
California Highway Patrol .....	12.895	21.683	0.038	34.616
Peace officers and firefighters .....	15.489	15.006	0.000	30.495
Other safety members .....	12.007	5.198	0.000	17.205

For the year ended June 30, 2014, the annual pension cost (APC) and the amount of contributions made by the primary government were each \$3.7 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 27. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2013, is also shown in Table 27.

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. The DB Program had 1,687 contributing employers at June 30, 2014 and, as of June 30, 2013, had 416,643 active and 182,576 inactive program members and 269,274 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, 2014, was approximately \$27.1 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, 2014, the CB Benefit Program had 32 contributing school districts and 35,066 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, 2014, the RB Program had 260 participants.

*Funding Policy:* DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Members and employers contribute a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate for members under the CalSTRS 2% at 60 formula is 8.00% of creditable compensation, while the contribution rate for members under the CalSTRS 2% at 62 formula 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 2013-14. The employer contribution rate is 8.25% of creditable compensation. In fiscal year 2013-14, 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 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 was required to contribute the additional quarterly payments at a contribution rate of 1.024% starting October 1, 2013. As of June 30, 2014, the state contributed \$201 million of the \$268 million total amount for fiscal year 2013-14.

Assembly Bill 1469 (AB 1469) was passed by the Legislature on June 15, 2014, signed into law on June 24, 2014, and took effect immediately. This bill was designed to address the long-term funding gap of the DB Program. It creates a plan to fully fund the DB Program by 2046 through increases in employer, State, and employee contributions. The portion of the state appropriation under Education Code section 22955(b) that is in addition to the 2.017% has been replaced by section 22955.1(b) in order to fully fund by 2046 the benefits in effect as of 1990.

As a result of AB 1469, the fourth quarterly payment of \$67 million was included in an increased first-quarter payment of \$94 million for fiscal year 2014-15, which was transferred on July 1, 2014.

Table 26 shows the CalSTRS' state contribution rates effective for fiscal year 2014-15 and beyond.

**Table 26**

**Schedule of CalSTRS' State Contribution Rates**

Effective Date	Base Rate	AB 1469 Increase for 1990 Benefit Structure	SBMA <sup>1</sup> Funding	Total State Appropriation to DB Program
July 1, 2014	2.017 %	1.437 %	2.50 %	5.954 %
July 1, 2015	2.017	2.874	2.50	7.391
July 1, 2016	2.017	4.311	2.50	8.828
July 1, 2017 to June 30, 2046	2.017	4.311	2.50	8.828
July 1, 2046 and thereafter	2.017	— <sup>2</sup>	2.50	4.517 <sup>2</sup>

<sup>1</sup> Supplemental Benefits Maintenance Account

<sup>2</sup> AB 1469 gives the CalSTRS board limited authority to adjust state contribution rates from July 1, 2017, through June 30, 2046 in order to eliminate the remaining unfunded actuarial obligation associated with the 1990 benefit structure. The board cannot increase the rate by more than 0.50 percent in a fiscal year, and if there is no unfunded actuarial obligation, the contribution rate imposed to pay for the 1990 benefit structure shall be reduced to 0 percent. Rates in effect prior to July 1, 2014, are reinstated, if necessary, to address any remaining 1990 unfunded actuarial obligation from July 1, 2046, and thereafter.

The DBS Program member contribution rate for service that exceeds one full year during a fiscal year is 8.0% and the employer rate is 8.0%.

For the year ended June 30, 2014, the employer and primary government contributions were approximately \$2.3 billion and \$1.4 billion, respectively. Actuarial valuations of the DB Program are performed annually. Information from the last valuation is shown in Table 27.

**Table 27****Actuarial Information – Pension Trusts – Public Employees’ Retirement Fund and State Teachers’ Retirement Defined Benefit Program Fund**

Valuation Date as Indicated

	<b>Public Employees’ Retirement Fund</b>	<b>State Teachers’ Retirement Defined Benefit Program Fund<sup>1</sup></b>
Last actuarial valuation .....	June 30, 2013	June 30, 2013
Actuarial cost method .....	Individual Entry Age Normal	Entry Age Normal
Amortization method .....	Level % of Payroll	Level % of Payroll, Open
Remaining amortization period .....	30 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 - 18.60	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
Year ended 6/30/14 .....	3,749	— <sup>2</sup>
Percent contribution		
Year ended 6/30/11 .....	100 %	47 %
Year ended 6/30/12 .....	100	46
Year ended 6/30/13 .....	100	44
Year ended 6/30/14 .....	100	— <sup>2</sup>
Funding as of last valuation (in millions)		
Actuarial value – assets .....	\$ 110,989	\$ 148,614
Actuarial accrued liabilities (AAL) – entry age .....	147,392	221,861
Unfunded actuarial accrued liability (UAAL) .....	36,403	73,247
Covered payroll .....	15,346	27,117
Funded ratio .....	75.3 %	67.0 %
UAAL as percent of covered payroll .....	237.2 %	270.1 %

<sup>1</sup> The State is a nonemployer 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 \$1.4 billion and \$2.3 billion, respectively, for the year ending June 30, 2014. Based on the most recent actuarial valuation, dated June 30, 2013, 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.

<sup>2</sup> CalSTRS implementation of GASB 67 in its 2013-14 fiscal year financial statements makes information related to the annual pension cost and the related percent contribution rates incomparable for financial presentation to prior years displayed.



## NOTE 25: POSTEMPLOYMENT HEALTH CARE BENEFITS

*State of California Other Postemployment Benefits Plan Description:* The primary government provides 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 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), respectively. Employer and retiree contributions are governed by the primary government and can be amended by the primary government through the Legislature. The State 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 separately issued annual financial statements, which can be obtained from CalPERS on its website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

Fifty-eight county superior courts (trial courts) are included in the primary government. However, each trial court is a separate employer for GASB Statement No. 45 reporting purposes. Fifty 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. Seven trial courts (Alameda, Del Norte, Fresno, Mendocino, Modoc, San Benito, and Stanislaus) have no plan. Twenty-one 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 2013-14 fiscal year, approximately 168,200 annuitants were enrolled to receive health benefits and approximately 139,000 annuitants were enrolled to receive dental benefits. As of July 1, 2013, the most recent actuarial valuation date, the trial courts had approximately 4,200 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. 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, as specified in the California Government Code. The State funds the cost of providing health and dental insurance to annuitants primarily on a pay-as-you-go basis, with a modest amount of prefunding for members of Bargaining Units 5, 12, and 16. The maximum 2014 monthly State contribution was \$642 for one-party coverage, \$1,218 for two-party coverage, and \$1,559 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. Twenty-one trial courts fund retirees' benefits on a strictly pay-as-you-go basis. The 2013 monthly contribution rate for the trial courts with single-employer defined benefit plans, the latest year for which contribution information is available, ranged from \$8 to \$1,134,429, with the average being \$119,867. One trial court (Yolo) continuously contributes 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 costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. Sonoma and Marin are on a pay-as-you-go plus 50% of direct-subsidy benefits funding policy (after

initial contribution) until their plans are fully funded. Orange contributed the larger of the ARC, or 3.5% of payroll, with at least the ARC contributed for 2014, with no commitment to future contributions. San Diego, a cost-sharing multiple-employer defined benefit plan, had a contribution rate of 1.94% of annual covered pension payroll. Seventeen other trial courts made contributions only in 2014, with five other trial courts contributing in other years (Placer in 2013 and 2014; San Mateo in 2013, 2014, and 2015; Nevada in 2012 and 2013; Santa Cruz in 2013; and Butte in 2014 and prior years, which fully funded the plan), but none of these 22 trial courts are committing to future trust contributions. Lassen is fully funded with no future contributions expected, Imperial has committed to \$20,000 per year for future contributions, and Santa Clara funding policy is set by the County and will increase to 70% of the ARC long term. For the year ended June 30, 2014, the State contributed \$1.9 billion toward annuitants' health and dental benefits. Of this amount, the trial courts represent \$73 million and certain discretely presented component units represent \$4 million.

*Annual Other Postemployment Benefits (OPEB) Cost and Net OPEB Obligation:* The State's annual OPEB cost (expense) is calculated based on the ARC. Table 28 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, 2014, and the two preceding years, including trial courts.

**Table 28**

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

(amounts in thousands)

<b>Fiscal Year Ended</b>	<b>Annual OPEB Cost</b>	<b>Percentage of Annual OPEB Cost Contributed</b>	<b>Net OPEB Obligation</b>
June 30, 2012	\$ 4,837,769	36.20 %	\$ 13,440,768
June 30, 2013	4,992,924	35.33	16,267,964
June 30, 2014	5,129,284	37.20	19,489,030



Table 29 presents the components of the State's net OPEB obligation to the OPEB plan, including trial courts.

**Table 29****Schedule of Net OPEB Obligations**

June 30, 2014

(amounts in thousands)

	<b>Amount</b>
Annual required contribution .....	\$ 5,046,539
Interest on net OPEB obligations .....	736,019
Adjustment to annual required contribution .....	(653,274)
<b>Annual OPEB cost .....</b>	<b>5,129,284</b>
Contributions made .....	(1,908,218)
Increase in net OPEB obligation .....	<b>3,221,066</b>
<b>Net OPEB obligations – beginning of year .....</b>	<b>16,267,964</b>
<b>Net OPEB obligations – end of year .....</b>	<b>\$ 19,489,030</b>

*Funded Status and Funding Progress:* As of June 30, 2014—the most recent actuarial valuation date for the State substantive plan—the actuarial accrued liability (AAL) for benefits was \$71.8 billion, and the actuarial value of assets was \$41 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$71.8 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$19.3 billion, and the ratio of the UAAL to the covered payroll was 373%.

For the trial courts, as of July 1, 2013—the most recent actuarial valuation date—the AAL for benefits was \$1.4 billion and the actuarial value of assets was \$30 million, resulting in an UAAL of \$1.4 billion. The covered payroll was \$931 million and the ratio of the UAAL to covered payroll was 149%.

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, 2014 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 2015 and 8.00% in 2016 initially, reduced to an ultimate rate of 4.50% in 2021. 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 active member payroll on an open basis over 30 years.

In the July 1, 2013 biennial actuarial valuations, the entry age normal cost method was used for 50 of the trial courts. The actuarial assumptions included a 3.75% investment rate of return for 40 trial courts. There are 10 other trial courts with investment rates of return ranging from 4.75% to 7.50%. The actuarial assumptions included an annual health care cost trend rate of 8.25% for most trial courts initially, reduced incrementally to an ultimate trend rate of 5.00% after five years. Annual inflation and payroll growth are assumed to be 2.75% and 3.00%, respectively, for most trial courts. The UAAL is amortized on an open basis over 30 years as a level percentage of payroll for 46 trial courts. Three other trial courts (Lassen, Orange, and Yolo) amortize on a closed basis as a level percentage of payroll over 29, 24, and 25 years, respectively. Alpine is amortizing using the level dollar amount over 24 years on a closed basis.

## **NOTE 26: SUBSEQUENT EVENTS**

The following information describes significant events that occurred subsequent to June 30, 2014, but prior to the date of the auditor's report.

### **A. Debt Issuances**

Between September 2014 and March 2015, the primary government issued \$5.5 billion in general obligation bonds to finance or refinance capital facilities or other voter-approved costs for public purposes, including children's hospitals; housing; prisons; libraries; earthquake safety and public building rehabilitation; transportation; highway safety, traffic reduction, air quality, and port security; public primary, secondary, community college and university education facilities; passenger rail; safe and clean drinking water; clean water; water security, clean air, parks, coastal and beach protection; seismic retrofit; high-speed rail; stem cell research; and veterans' homes.

In September 2014, the primary government issued \$110 million in veterans general obligation bonds to finance or refinance obligations that were issued to provide funds for financing of contracts for the purchase of homes and farms for military veterans who reside in California.

In August 2014, the California State University issued \$748 million in revenue bonds to refund certain maturities of Systemwide Revenue Bonds series 2004A, 2005A, and 2005C; repay bond anticipation notes, refund other outstanding bond indebtedness by an auxiliary organization; and fund new capital projects.

In October 2014, the State Public Works Board issued \$250 million 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, Department of State Hospitals, and Judicial Council of California.

In October 2014 and November 2014, the Department of Water Resources issued a combined total of \$795 million in water system revenue bonds to retire or redeem certain outstanding bonds and commercial paper notes, to fund deposits to the debt service reserve account, to fund capitalized interest, and to pay related issuance costs.

### **B. Cash Management**

In September 2014, the State issued \$2.8 billion of Revenue Anticipation Notes to fund, in part, the State's cash management needs of the 2014-15 fiscal year by supporting the cash flow needs of the General Fund.

## C. Other

In August 2014, the Electric Power Fund received \$142 million in energy settlements to resolve claims arising from events and transactions in Western Energy Markets during the period of January 1, 2000, through June 20, 2001.

In September 2014, CalPERS received a settlement check of \$88 million from Citigroup MBS Securities related to residential mortgage-backed securities.

In October 2014, CalPERS received \$249 million from Bank of America as part of a settlement related to mortgage-backed securities.

In the November 4, 2014 general election:

- Voters passed Proposition 1 authorizing the issuance of \$7.1 billion of general obligation bonds and reallocating \$425 million of unused bond authority from prior water bond acts for state water supply infrastructure projects.
- Voters passed Proposition 2 requiring the annual transfer of 1.5% of general fund revenue to the state budget stabilization account, and personal capital gain tax revenues exceeding 8% of general fund revenues to the budget stabilization account and, under certain conditions, a dedicated K-14 school reserve fund. The proposition also requires that half of the budget stabilization account revenues be used to repay state debts and unfunded liabilities. Proposition 2 allows limited use of the state budget stabilization account in the event of an emergency or if there is a state budget deficit. Proposition 2 caps the state budget stabilization account at 10% of general fund revenues, directing the remainder to infrastructure.
- Voters passed Proposition 47 requiring, absent prior conviction for certain serious offenses, misdemeanor sentencing for certain drug possession offenses and certain property crimes involving amounts of \$950 or less. Proposition 47 requires the resentencing of persons serving felony sentences for these offenses unless the court finds unreasonable public safety risk. Any savings are to be applied to mental health and drug treatment programs, K-12 schools, and crime victims.

In November 2014, Standard and Poor's Rating Services raised the State's general obligation rating to "A+" from "A", citing as a motivating factor the November 4, 2014 voter approval of Proposition 2 that strengthens the budget stabilization account.

In November 2014, the primary government entered into a note purchase agreement with Bank of America allowing the State to request the bank to purchase up to \$500 million of general obligation commercial paper.

In February 2015, Fitch raised the State's general obligation rating to "A+" from "A", citing the State's continued improvement in its fundamental fiscal position, institutionalized changes to its fiscal operations, and ongoing economic and revenue recovery as contributing to an improved financial position and enhancing the State's ability to address future fiscal challenges.

California's demand for unemployment insurance benefits required the State to continue borrowing from the U.S. Department of Labor during the 2014-15 fiscal year. As of June 30, 2014, the State had \$7.6 billion in outstanding loans with the U.S. Department of Labor which were used to cover deficits in the Unemployment Programs Fund. As of March 19, 2015, the State had an outstanding loan balance of \$8.1 billion. While the State continued to request additional loans during 2015, it estimates that these loans will be fully repaid by 2019.

# **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, 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
June 30, 2013	110,989	147,392	36,403	75.3	15,346	237.2

### 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, 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
June 30, 2013	148,614	221,861	73,247	67.0	27,117	270.1

### 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)
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#### State substantive plan

June 30, 2012	\$ 8	\$ 63,845	\$ 63,837	0.0 %	\$ 18,710	341.2 %
June 30, 2013	10	64,585	64,574	0.0	18,060	357.6
June 30, 2014	41	71,814	71,773	0.0	19,250	372.8

#### Trial Courts <sup>1</sup>

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
July 1, 2013	30	1,421	1,391	2.1	931	149.4

<sup>1</sup> The trial courts reporting is based on 51 individual biennial actuarial valuations as of July 1, 2013.

Note: The University of California provides 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., Discretely Presented Component Units.

## 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, 2014, are in the following categories and amounts: state highway infrastructure (completed highway projects) totaling \$65.2 billion, land purchased for highway projects totaling \$13.5 billion, and infrastructure construction-in-progress (uncompleted highway projects) totaling \$12.5 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, 2014, donations are \$74,290 of infrastructure land, and relinquishments are \$61 million of state highway infrastructure (completed highway projects) and \$13 million of infrastructure land.

### B. Condition Baselines and Assessments

#### 1. Bridges

The State uses the Bridge Health Index (BHI)—a numerical rating scale from 0 to 100 that uses element-level inspection data—to determine the aggregate condition of its bridges. The inspection data is based on the American Association of State Highway and 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 following table shows the State's established condition baseline and actual BHI for fiscal years 2011-12 through 2013-14:

<b>Fiscal Year Ended June 30</b>	<b>Established BHI Baseline <sup>1</sup></b>	<b>Actual BHI</b>
2012	80.0	94.5
2013	80.0	94.8
2014	80.0	95.6

<sup>1</sup> The actual statewide 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, 2014:

<b>BHI Description</b>	<b>Bridge Count</b>	<b>Percent</b>	<b>Network BHI</b>
Excellent	7,211	54.96 %	99.9
Good	4,635	35.33	96.9
Acceptable	680	5.18	86.3
Fair	132	1.01	74.2
Poor	102	0.78	62.8
Does not carry traffic	360	2.74	93.2
<b>Total</b>	<b>13,120</b>	<b>100.00 %</b>	

## 2. Roadways

The State conducts a periodic pavement condition survey, which evaluates ride quality and structural integrity and identifies the number of distressed lane miles. The State classifies its roadways' pavement condition by the following descriptions:

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

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

The following table shows the State's established condition baseline and actual distressed lane miles from the last three completed pavement-condition surveys:

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

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

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

<sup>3</sup> The State's compliance with GASB 34, which requires a road condition assessment every three years, temporarily lapsed in March 2011.

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

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

### C. Budgeted and Actual Preservation Costs

The estimated budgeted preservation costs represent the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represent the cumulative cost to date for the projects approved and work scheduled in each fiscal year.

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

<b>Fiscal Year Ended June 30</b>	<b>Estimated Budgeted Preservation Costs (in millions)</b>	<b>Actual Preservation Costs (in millions)</b>
2010	\$ 2,162	\$ 698
2011	2,802	1,394
2012	2,722	1,806
2013	1,598	989
2014	2,069	612



## Budgetary Comparison Schedule

### General Fund and Major Special Revenue Funds

**Year Ended June 30, 2014**

(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
<b>REVENUES</b>				
Corporation tax .....	\$ 7,971,000	\$ 8,107,000	\$ 8,724,718	\$ 617,718
Intergovernmental .....	—	—	—	—
Cigarette and tobacco taxes .....	89,000	86,000	86,378	378
Inheritance, estate, and gift taxes .....	—	—	—	—
Insurance gross premiums tax .....	2,143,000	2,287,000	2,362,738	75,738
Vehicle license fees .....	19,985	19,985	21,833	1,848
Motor vehicle fuel tax .....	—	—	—	—
Personal income tax .....	64,287,000	66,522,000	66,782,714	260,714
Retail sales and use taxes .....	22,920,000	22,759,000	22,250,163	(508,837)
Other major taxes and licenses .....	351,200	352,200	355,367	3,167
Other revenues .....	2,019,723	1,704,815	1,835,678	130,863
<b>Total revenues .....</b>	<b>99,800,908</b>	<b>101,838,000</b>	<b>102,419,589</b>	<b>581,589</b>
<b>EXPENDITURES</b>				
State and consumer services .....	14,081	13,593	11,483	2,110
Business and transportation .....	91,052	91,118	91,073	45
Resources .....	1,109,179	1,262,638	1,208,336	54,302
Health and human services .....	27,518,481	29,390,387	28,591,476	798,911
Correctional programs .....	8,610,145	9,348,790	9,184,218	164,572
Education .....	48,408,996	49,570,274	49,546,886	23,388
General government:				
Tax relief .....	421,734	425,256	421,734	3,522
Debt service .....	4,800,543	4,800,543	4,751,765	48,778
Other general government .....	4,327,934	4,478,542	4,201,023	277,519
<b>Total expenditures .....</b>	<b>95,302,145</b>	<b>99,381,141</b>	<b>98,007,994</b>	<b>1,373,147</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers from other funds .....	—	—	1,154,221	—
Transfers to other funds .....	—	—	(1,338,685)	—
Other additions and deductions .....	—	—	(102,379)	—
<b>Total other financing sources (uses) .....</b>	<b>—</b>	<b>—</b>	<b>(286,843)</b>	<b>—</b>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses .....	—	—	4,124,752	—
<b>Fund balances – beginning .....</b>	<b>—</b>	<b>—</b>	<b>4,285,137</b>	<b>—</b>
<b>Fund balances – ending .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 8,409,889</b>	<b>\$ —</b>

Federal				Transportation			
Budgeted Amounts		Actual Amounts	Variance With Final Budget	Budgeted Amounts		Actual Amounts	Variance With Final Budget
Original	Final			Original	Final		
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
60,477,098	60,477,098	60,477,098	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	6,026,194	6,014,023	6,065,747	51,724
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,796,510	3,859,470	3,900,966	41,496
26	26	26	—	400,774	461,636	385,002	(76,634)
<b>60,477,124</b>	<b>60,477,124</b>	<b>60,477,124</b>	<b>—</b>	<b>10,223,478</b>	<b>10,335,129</b>	<b>10,351,715</b>	<b>16,586</b>
5,411	5,411	5,411	—	115,770	115,770	102,987	12,783
5,069,737	5,069,737	5,069,737	—	11,587,798	11,555,219	10,523,981	1,031,238
259,979	259,979	259,979	—	234,072	234,155	233,369	786
44,172,988	44,172,988	44,172,988	—	3,418	3,418	2,656	762
88,228	88,228	88,228	—	—	—	—	—
6,727,357	6,727,357	6,727,357	—	2,649	2,649	2,118	531
—	—	—	—	—	—	—	—
—	—	—	—	686	2,350	1,399	951
962,624	962,624	962,624	—	665,866	666,600	658,196	8,404
<b>57,286,324</b>	<b>57,286,324</b>	<b>57,286,324</b>	<b>—</b>	<b>12,610,259</b>	<b>12,580,161</b>	<b>11,524,706</b>	<b>1,055,455</b>
—	—	8,461,005	—	—	—	18,492,786	—
—	—	(11,636,639)	—	—	—	(21,415,565)	—
—	—	(16,758)	—	—	—	(1,116,593)	—
—	—	<b>(3,192,392)</b>	<b>—</b>	—	—	<b>(4,039,372)</b>	<b>—</b>
—	—	(1,592)	—	—	—	(5,212,363)	—
—	—	<b>10,769</b>	<b>—</b>	—	—	<b>22,442,954</b>	<b>—</b>
<b>\$ —</b>	<b>\$ —</b>	<b>\$ 9,177</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 17,230,591</b>	<b>\$ —</b>

(continued)

## Budgetary Comparison Schedule (continued)

### General Fund and Major Special Revenue Funds

**Year Ended June 30, 2014**

(amounts in thousands)

	Environmental and Natural Resources			
	Budgeted Amounts		Actual Amounts	Variance With Final Budget
	Original	Final		
<b>REVENUES</b>				
Corporation tax .....	\$ —	\$ —	\$ —	\$ —
Intergovernmental .....	—	—	—	—
Cigarette and tobacco taxes .....	—	—	—	—
Inheritance, estate, and gift taxes .....	—	—	—	—
Insurance gross premiums tax .....	—	—	—	—
Vehicle license fees .....	—	—	—	—
Motor vehicle fuel tax .....	—	—	—	—
Personal income tax .....	—	—	—	—
Retail sales and use taxes .....	—	—	—	—
Other major taxes and licenses .....	153,108	153,108	153,108	—
Other revenues .....	3,464,344	3,464,344	3,464,344	—
<b>Total revenues .....</b>	<b>3,617,452</b>	<b>3,617,452</b>	<b>3,617,452</b>	<b>—</b>
<b>EXPENDITURES</b>				
State and consumer services .....	79,501	79,501	64,120	15,381
Business and transportation .....	8,928	8,928	8,928	—
Resources .....	4,784,304	4,523,630	4,047,506	476,124
Health and human services .....	218,588	170,386	106,722	63,664
Correctional programs .....	—	—	—	—
Education .....	16,140	16,140	14,089	2,051
General government:				
Tax relief .....	—	—	—	—
Debt service .....	—	—	—	—
Other general government .....	122,080	110,587	89,814	20,773
<b>Total expenditures .....</b>	<b>5,229,541</b>	<b>4,909,172</b>	<b>4,331,179</b>	<b>577,993</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers from other funds .....	—	—	896,385	—
Transfers to other funds .....	—	—	(740,256)	—
Other additions and deductions .....	—	—	54,934	—
<b>Total other financing sources (uses) .....</b>	<b>—</b>	<b>—</b>	<b>211,063</b>	<b>—</b>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses .....	—	—	(502,665)	—
<b>Fund balances – beginning .....</b>	<b>—</b>	<b>—</b>	<b>12,029,423</b>	<b>*</b>
<b>Fund balances – ending .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 11,526,758</b>	<b>\$ —</b>

\* Restated

(concluded)

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

**June 30, 2014**

(amounts in thousands)

	General	Major Special Revenue Funds		
		Federal	Transportation	Environmental and Natural Resources
<b>Budgetary fund balance reclassified into</b>				
GAAP statement fund structure .....	\$ 8,409,889	\$ 9,177	\$ 17,230,591	\$ 11,526,758
<b>Basis difference:</b>				
Interfund receivables .....	49,234	—	3,354,281	829,227
Loans receivable .....	126,121	201,804	—	1,113,482
Interfund payables .....	(6,123,537)	—	(2,316)	(25,000)
Escheat property .....	(820,249)	—	—	—
Bonds authorized but unissued .....	—	—	(15,119,755)	(5,751,377)
Tax revenues .....	(717,500)	—	—	—
Fund classification changes .....	447,754	1,593	—	—
Other .....	4,363	—	2,529,013	12,808
<b>Timing difference:</b>				
Liabilities budgeted in subsequent years .....	(8,820,671)	(1,000)	(525,590)	(75,344)
<b>GAAP fund balance (deficit) – ending .....</b>	<b>\$ (7,444,596)</b>	<b>\$ 211,574</b>	<b>\$ 7,466,224</b>	<b>\$ 7,630,554</b>

### Notes to the Required Supplementary Information

#### Budgetary Comparison Schedule

The State annually reports its financial condition based on a Generally Accepted Accounting Principles (GAAP) basis and on the State's budgetary provisions (budgetary basis). The Budgetary Comparison Schedule for the 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. While the encumbrances relate to all programs' expenditures on a budgetary basis, adjustments for encumbrances are budgeted under other general government.

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. The supplement includes a 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 by emailing the State Controller's Office, Division of Accounting and Reporting at [StateGovReports@sco.ca.gov](mailto:StateGovReports@sco.ca.gov).

## 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 is presented on the previous page and the reconciling items are explained in the following paragraphs.

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

### Basis Difference

*Interfund Receivables and Loans Receivable:* Loans made to other funds or to other governments are normally recorded as either expenditures or transfers on a budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a \$49 million increase to the fund balance in the General Fund, a \$3.4 billion increase to the fund balance in the Transportation Fund, and a \$829 million increase to the fund balance in Environmental and Natural Resources Fund. The adjustments related to loans receivable caused increases of \$126 million in the General Fund, \$202 million in the Federal Fund, and \$1.1 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 \$6.1 billion decrease to the budgetary fund balance in the General Fund, \$2 million decrease to the Transportation Fund, and \$25 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 \$820 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 \$15.1 billion decrease to the fund balance in the Transportation Fund and a \$5.8 billion decrease in the Environmental and Natural Resources Fund.

*Tax Revenues:* Estimated tax payments are accrued on a budgetary basis pursuant to Chapter 751, Statutes of 2008. However, in accordance with GAAP, tax payments are accrued based on the portion of estimated net final payments related to the fiscal year. This adjustment caused a fund balance decrease of \$718 million in the General Fund.

*Fund Classification Changes:* The fund balance amounts for governmental funds have been reclassified in accordance with governmental accounting standards. These reclassifications caused fund balance increases of \$448 million in the General Fund and \$2 million in the Federal Fund. These increases represent the fund balances of funds that are not considered part of the General Fund or the Federal Fund, respectively, for any budgetary purpose 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 increases of \$5 million in the General Fund, \$2.5 billion in the Transportation Fund, and \$13 million in the 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 \$8.8 billion in the General Fund, \$1 million in the Federal Fund, \$526 million in the Transportation Fund, and \$75 million in the Environmental and Natural Resources Fund. The large decrease in the General Fund primarily consists of \$3.9 billion for deferred apportionment payments to K-12 schools and community colleges, \$2.8 billion for medical assistance, \$989 million for June 2014 payroll that was deferred to July 2014, \$555 million for pension contributions, \$284 million for workers' compensation claims, and \$191 million in tax overpayments.

# **Part Two**

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**State of California Internal Control  
and State and Federal Compliance  
Audit Report for the Year Ended  
June 30, 2014**

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

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## 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*

### Independent Auditor's Report

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, 2014, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated March 19, 2015. 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 79 percent of the assets and deferred outflows and 30 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 93 percent of the revenues of the discretely presented component units.

#### ***Fund Financial Statements***

- The Safe Drinking Water State Revolving fund, that represents 15 percent of the assets and deferred outflows, and 6 percent of the additions, revenues, and other financing sources of the Environmental and Natural Resources fund, a major governmental fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, State Lottery fund, and California State University fund.
- The Golden State Tobacco Securitization Corporation, the Public Building Construction, 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 58 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 2014-1 through 2014-4.

A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements to be a significant deficiency—item 2014-5.

## 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## Entity's Responses to Findings

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.

## 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 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, CPA  
Deputy State Auditor

March 19, 2015

## **Schedule of Findings**

**STATE OF CALIFORNIA  
SCHEDULE OF FINDINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

**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**

## DEPARTMENT OF EDUCATION

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Reference Number: 2014-1

### Condition

The Department of Education's (Education) Federal Trust Fund liabilities and expenditures were understated by \$1.3 billion for fiscal year 2013–14. Specifically, Education incorrectly reduced its liabilities and expenditures by \$1.3 billion when it submitted its generally accepted accounting principles (GAAP) adjustments to the State Controller's Office (Controller's Office).

This understatement arose due to confusion over a revision the Department of Finance (Finance) made to department reporting requirements for the *Report of Expenditures of Federal Funds* (Report 13). In September 2013, Finance revised *State Administrative Manual* section 7974, adding a requirement that payments to sub-recipients be recorded on a cash basis on the Report 13. Finance uses the information on the Report 13 to prepare the Schedule of Expenditures of Federal Awards.

In January 2015, Education submitted corrected information to the Controller's Office.

### Criteria

California Government Code Section 12461 requires the Controller's Office to issue an annual financial report that is prepared in accordance with 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's Office 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

Education should revise its procedures to ensure that the GAAP entries it sends to the Controller's Office allow it to prepare financial statements in accordance with GAAP.

### Department's View and Corrective Action Plan

Education concurs with this finding; however, the condition was the result of incorrect and conflicting information that was communicated from control agencies as explained above. The reporting requirements that were disseminated to state agencies, ultimately leading to this finding, have been discussed with the control agencies and resolved.

## DEPARTMENT OF HEALTH CARE SERVICES

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Reference Number: 2014-2

### Condition:

The Department of Health Care Services (DHCS) understated Medi-Cal expenditures and revenues for fiscal year 2013–14 in the Federal Trust Fund by \$626.2 million. Additionally, DHCS overstated Medi-Cal expenditures for fiscal year 2013–14 in the General Fund by \$389.2 million. 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 must 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' misstatements by program.

### Overstated Accruals for the Fee-For-Service Health Care Delivery System and for Noncontract Hospital Inpatient Cost Settlements

DHCS overstated expenditures and related revenues by \$455.5 million in the Federal Trust Fund and overstated expenditures by \$455.5 million in the General Fund for the Fee-For-Service Health Care Delivery System (Fee-For-Service). DHCS uses a fiscal intermediary to process payments to health care providers for the medical care and services they deliver to Medi-Cal eligible patients. DHCS calculated its accrual using actual payment data and payment estimates. The overstatement occurred because DHCS double counted actual payments from early in the subsequent year when calculating the accrual. The Chief of DHCS' Base Estimates Unit explained that DHCS uploaded payment data files, from the fiscal intermediary, into its accrual spreadsheet twice, thereby doubling the amount of actual payments. DHCS added a record count verification step to ensure that it only loads payment data files once.

DHCS also overstated expenditures and related revenues by \$116.2 million in the Federal Trust Fund and overstated expenditures by \$116.2 million in the General Fund for Noncontract Hospital Inpatient Cost Settlements. DHCS initially pays a noncontract hospital an interim payment for the cost of services the hospital has delivered to Medi-Cal beneficiaries. The noncontract hospital then submits an annual cost report and DHCS pays it a tentative settlement amount. Finally DHCS audits the hospital's costs and completes a final cost settlement that results in either a payment to the hospital above the tentative settlement or a collection from the hospital for overpayments. In its accrual, DHCS included amounts that it had paid to hospitals by June 30, 2014 and that were thus already included in its financial statements. DHCS included an accrual for noncontract hospital cost settlements for the first time in its fiscal year 2013–14 Medi-Cal accrual, but it did not create written procedures related to calculating this portion of the overall accrual. As a result, DHCS overstated expenditures on a GAAP basis by accruing expenditures that it had already included in its budgetary basis statements.

### Understated Accruals for Medi-Cal Managed Care Program

DHCS understated expenditures and related revenues by \$1.2 billion in the Federal Trust Fund, and understated expenditures by \$182.5 million in the General Fund for the Medi-Cal Managed Care program (Managed Care). Managed Care health plan providers help Medi-Cal beneficiaries find doctors, pharmacies and health education programs. In contrast to Fee-For-Service, Managed Care plan providers are paid a monthly rate for each individual enrolled with them. DHCS validates provider information and generates invoices for payment to Managed Care plans. DHCS uses its Capitation Management (CAPMAN) system to generate validated invoices for payment. To calculate the accrual, DHCS staff requested and used a query of CAPMAN data to estimate invoices to be generated through October 2014 for service periods on or before June 30, 2014. However, DHCS' query failed to include invoices generated by June 30, 2014 that had not yet been paid by fiscal year-end. This oversight caused DHCS to obtain an incomplete set of invoice data to use in preparing its accrual. According to the



Chief of the Capitation Payment Unit, DHCS did not provide written guidance to its staff on how to prepare the Managed Care accrual. Without documented processes to guide staff in preparing all 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.

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 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:

- Ensure proper implementation of the updated accrual procedures it has established for the Fee-For-Service program.
- Develop written procedures to ensure it accrues only expenditures outstanding at year-end for Noncontract Hospital Inpatient Cost Settlements.
- Develop and document a process to ensure it accrues all unpaid expenditures related to the Managed Care program.

**Department's View and Corrective Action:**

Recommendation 1: DHCS agrees with the recommendation. Corrective action has been identified and Fiscal Forecasting implemented the second verification step in September 2014. As identified in the audit report, DHCS added a record count verification step to ensure that it only loads payment data files once. The analyst responsible for uploading the file into Fiscal Forecasting's database reviews the record count for reasonability. This step occurs earlier than the initial verification process of comparing the weekly checkwrite files to the monthly paid claims data files. The initial verification step occurs once the monthly paid claims file is available via the MIS/DSS system. The weekly checkwrite files for a given month are summed and compared to the monthly paid claims file.

Recommendation 2: DHCS agrees with the recommendation. DHCS Audits and Investigations will complete written procedures by April 17, 2015.

Recommendation 3: DHCS agrees with the recommendation. DHCS will develop and document a process to ensure it accrues all unpaid expenditures related to the Managed Care Program, no later than June 30, 2015.

## DEPARTMENT OF HEALTH CARE SERVICES

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Reference Number: 2014-3

### Condition:

The Department of Health Care Services (DHCS) overstated expenditures in the General Fund and understated expenditures in the Nonmajor Governmental Funds by \$448 million for fiscal year 2013–14. Within the Nonmajor Governmental Funds, DHCS understated expenditures in the Children's Health and Human Services Special (Children's Health Fund) and the Long Term Care Quality Assurance (Quality Assurance Fund) funds by \$207 million and \$241 million, respectively. Specifically, DHCS did not correctly account for Medi-Cal reimbursements in accordance with generally accepted accounting principles (GAAP). For budgetary purposes, DHCS reports Medi-Cal expenditures on a cash-basis. GAAP, however, requires governmental funds to be accounted for on a modified accrual basis. Specifically, expenditures must 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.

DHCS accounts for both the gross premium tax and the sales tax on managed care plans in the Children's Health Fund. It also accounts for the long-term care quality assurance fees in the Quality Assurance Fund. The purpose of the Children's Health Fund is to finance the state's share of managed care payments for health care services. The purpose of the Quality Assurance Fund is to provide additional reimbursement to, and support quality improvement efforts of, program participants. Both funds are used to enhance federal participation in these programs. DHCS's Accounting Section management explained that the General Fund initially pays for program expenditures as they are incurred, and these two funds subsequently reimburse the General Fund for their share of the expenditures. For fiscal year 2013–14, DHCS properly accrued and reported revenues in the Children's Health Fund and the Quality Assurance Fund; however, it did not submit an adjusting entry to accrue the related reimbursements to the General Fund. This occurred because DHCS's procedures for determining which funds need an adjusting entry to comply with GAAP did not include steps to identify funds that accumulate revenues to reimburse other funds, such as the General Fund. By not accruing these reimbursements as required by GAAP, DHCS risks materially misstating expenditures in the General Fund and the Nonmajor Governmental Funds.

### 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.

Codification of Governmental Accounting and Financial Reporting Standards (GAFRS) Section 1600 states that financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. The current financial resources measurement focus and modified accrual basis of accounting require an expenditure 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.

GAFRS Section 1800 defines reimbursements as repayments from the fund responsible for a particular expenditure to the fund that initially paid for them. Reimbursements should not be displayed in the financial statements. The GAAP manual instructs agencies to record a reduction in expenditures for the reimbursed fund and to record an increase in expenditures for the reimbursing fund.

**Recommendation:**

To ensure its financial statements are properly presented at fiscal year-end, DHCS should:

- Report all activity for the governmental funds it manages on a modified accrual basis.
- Expand its accrual methodologies to ensure the effect of reimbursements on expenditures is reported in the appropriate fund.

**Department's View and Corrective Action:**

Recommendation 1: DHCS agrees with the recommendation and is currently in the process of updating the written procedures to ensure the reporting of all activity for the governmental funds managed are on a modified accrual basis. It is estimated the procedures will be written and implemented by April 30, 2015.

Recommendation 2: DHCS agrees with the recommendation and is currently in the process of updating the written procedures to expand the accrual methodologies to ensure the effect of reimbursements on expenditures is reported in the appropriate fund. It is estimated the procedures will be written and implemented by April 30, 2015.

## DEPARTMENT OF TRANSPORTATION

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Reference Number: 2014-4

### Condition

The Department of Transportation (Caltrans) submitted fiscal year 2013–14 capital assets reports to the State Controller's Office (Controller's Office) that included material misstatements related to the highway infrastructure of the State of California (State) due to inadequate review within Caltrans' accounting division and programming logic errors on the part of Caltrans' information technology staff. Subsequent to its first submission of financial reports in August 2014, Caltrans submitted multiple revisions of its capital assets reports to the Controller's Office that continued to contain materially misstated information. Caltrans submitted a final version of its capital assets reports in January 2015. The final amounts for Caltrans' capital assets reported in the State's *Comprehensive Annual Financial Report (CAFR)* differed significantly from those in Caltrans' first submission. Compared to the final amounts, the first version understated the State's beginning infrastructure balance by \$2.4 billion, understated its ending infrastructure balance by \$1.6 billion, and overstated its net infrastructure additions by \$802.1 million.

The two Caltrans funds primarily affected by beginning balance adjustments were the State Highway Account, whose infrastructure related balances increased \$931.6 million, and the Transportation Congestion Relief Fund, whose infrastructure related balances increased \$922.1 million. In both cases, the increase represents previously unreported infrastructure costs incurred in prior years. The adjustment was particularly significant for the Traffic Congestion Relief Fund, which previously reported just \$9.4 million in infrastructure assets. Significant adjustments like these are an indication that Caltrans staff did not accurately identify all infrastructure costs in previous years.

Even though the chief of Caltrans' Service Transactions and Asset Reconciliation Section (section chief) stated that she performed reviews of Caltrans' capital assets reports before submission, Caltrans' accounting division still required assistance from the California State Auditor to identify and correct certain issues, some of which would have resulted in significant misstatements. For example, in one version Caltrans submitted a capital assets report to the Controller's Office showing that the State Highway Account had only \$35.5 million in infrastructure additions for fiscal year 2013–14. After our office questioned the low level of additions, Caltrans submitted a revised capital assets report with \$734.1 million in infrastructure additions, an amount more consistent with additions in recent years. Caltrans also submitted capital assets reports to the Controller's Office that increased completed infrastructure without similarly decreasing construction work in progress. Because infrastructure additions represent completed projects that have been deducted from the work in progress account, infrastructure additions and work in progress deductions should be closely aligned. Finally, Caltrans submitted a capital assets report that inappropriately presented beginning balance adjustments as additions and deductions to capital assets when the adjustments should have been presented as restatements to the beginning balance. Our identification of such issues generally required no more than a cursory review of Caltrans' capital assets reports and underscores the need for Caltrans to improve its review procedures.

According to the section chief, programming logic errors on the part of Caltrans' information technology staff also contributed to the need for report revisions. For instance, she explained that the low level of infrastructure additions noted previously was caused by an error in computer programming logic. Accounting division staff failed to detect the error because they did not perform a reasonableness check of the capital assets reports created by information technology staff. A thorough review of information technology staff's work is important because they prepare the reports that underpin Caltrans' infrastructure reporting.

Given the magnitude of the State's infrastructure, even seemingly minor programming errors can contribute to significant misstatements. Caltrans' reported infrastructure constitutes a large majority of the State's capital assets. Specifically, Caltrans' ending balances of land, state highway infrastructure,

and construction in progress totaled about \$91 billion, representing 73 percent of the State's net capital assets balance of \$125 billion at June 30, 2014. Accordingly, misstatements of capital assets by Caltrans can significantly affect the State's overall capital assets reporting.

### Criteria

Sections 1400.105 through 108 of the Codification of 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 the assets at or above a condition level established and disclosed by the government. The State uses this approach in accounting for its 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 *Controller's Year-End Financial Reports Procedure Manual (Procedure Manual)* indicates that beginning balances must agree with the prior year's ending balances except for restatements of the beginning balance for unreported or misclassified items. Capital assets reports with such restatements are to include a footnote that includes a description and the amount of the adjustment. The *Procedure Manual* also indicates that the addition column of capital assets reports should only be used for assets acquired or internally generated during the current fiscal year.

The *State Administrative Manual* provides guidelines indicating that when an internally built asset is completed, the relevant asset account should be increased and construction work in progress should be decreased.

### Recommendations

Caltrans should develop robust written procedures for each Caltrans unit involved in reporting the State's capital assets and should regularly review and update these procedures. Since Caltrans' information technology staff plays an important role in the preparation of Caltrans' capital assets reports, Caltrans' procedures should provide clear instructions to them on how to accurately produce financial information.

Caltrans should also provide training to its supervisory staff to ensure that financial information reported to the Controller's Office is materially correct. To prevent multiple submissions to the Controller's Office containing material misstatements, Caltrans should conduct a thorough supervisory review of its capital assets reports. Furthermore, Caltrans should develop and analyze trendlines or other analytics with regard to components of capital assets within its capital assets reports. This would provide additional insight as to the reasonableness of its overall capital assets reporting. For example, Caltrans could perform a trend analysis to determine whether the year's capital assets activities are consistent with recent historical data or could compare report amounts with Caltrans' expectations of capital assets activities, based on its knowledge of the projects it manages.

### Department's View and Corrective Action Plan

Caltrans will examine and expand its current written procedures for reporting infrastructure capital assets, including a focus on addressing shortcomings identified by the audit report. Furthermore, Caltrans will annually re-evaluate the criteria used for capitalizing these assets. Caltrans will establish checklists for both staff and supervisors as a guide for the preparation, review and approval for the reports. The checklist will include procedures for trend analysis to ensure capital asset reporting is reasonable and consistent with historical reporting. Multiple levels of management will review the reporting before it is submitted to the Controller's Office. Caltrans will follow a formal written change request process to define and document instructions and criteria provided to its Information Technology staff for producing the financial information needed for the reporting. These improvements will be adopted by June 30, 2015. Caltrans will engage the California State Audit staff periodically as procedures are developed and implemented to ensure the corrective actions are satisfactory.

## DEPARTMENT OF TRANSPORTATION

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Reference Number: 2014-5

### Condition

The Department of Transportation (Caltrans) understated its fiscal year 2013-14 liabilities and expenditures by \$249 million for the Federal Trust Fund. On a budgetary/legal basis, encumbrances are recognized in Caltrans' Federal Trust Fund records when commitments related to unperformed contracts for goods or services are made. However, according to generally accepted accounting principles (GAAP), encumbrances should not be recognized as liabilities or expenditures until the goods or services are received. Caltrans appropriately submitted an entry to the State Controller's Office (Controller's Office) to eliminate encumbrances to bring its financial information in line with GAAP. However, Caltrans' entry improperly included \$249 million for valid obligations for goods or services which had already been received, resulting in an understatement. After we pointed out this error, Caltrans submitted an appropriate adjustment to the Controller's Office.

### Criteria

California Government Code Section 12461 requires the Controller's Office to issue an annual financial report that is prepared in accordance with 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's Office 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, Caltrans should strengthen its review process to ensure that the Federal Trust Fund entry it submits to the Controller's Office to remove encumbrances does not include valid obligations.

### Department's View and Corrective Action Plan

Caltrans employees who prepare the Federal Trust Fund GAAP entries will be reminded to follow existing written procedures and use existing checklists for encumbrances and obligations. Furthermore, Caltrans supervisors who review and approve the Federal Trust Fund GAAP entries will be reminded to ensure procedures are followed and checklists are completed. This will occur by March 31, 2015.

Date: March 26, 2015

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April Ramos, CPA  
Shaila Shankar  
Derek J. Sinutko, PhD

# **Part Three**

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**Federal Compliance Audit Report for  
the Year Ended June 30, 2014**



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## **Auditors' Section**



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**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, 2014.

***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, for the year ended June 30, 2014, 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 Agency, a component unit of the State of California, which received \$5.4 billion, \$2.4 billion, \$102.3 million, \$211.5 million, and \$59.7 million, respectively, in federal awards which are not included in the Schedule for the year ended June 30, 2014. 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*. Our opinion is not modified with respect to this matter.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2015 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. 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  
March 19, 2015



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**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* and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations***

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, for the year ended June 30, 2014, and have issued our report thereon dated March 19, 2015. Our report includes an emphasis of matter paragraph to describe those entities which are not included in the Schedule. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

**Internal Control Over Financial Reporting**

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 2014-001 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 the 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* 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  
March 19, 2015



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## **Independent Auditors' Report on Compliance for Each Major Federal Program and Report on Internal Control Over Compliance Required by OMB Circular A-133**

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, 2014. 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 \$5.4 billion, \$2.4 billion, \$102.3 million, \$211.5 million, and \$59.7 million, respectively, in federal awards which are not included in the schedule of expenditures of federal awards for the year ended June 30, 2014. 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 the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified and modified audit opinions on compliance. 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	FEDERAL PROGRAM OR CLUSTER
Davis-Bacon Act			
	2014-015	California Department of Transportation	High-Speed Rail Corridors and Intercity Passenger Rail Services - Capital Assistance Grants (20.319) (ARRA)
Eligibility, Subrecipient Monitoring			
	2014-003	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
Equipment and Real Property Management			
	2014-023	California Department of Transportation	Transit Services Cluster
Subrecipient Monitoring			
	2014-028, 2014-029	Department of Health Care Services	Medicaid Cluster Children's Health Insurance Program (CHIP) (93.767)
Special Tests and Provisions			
	2014-013	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 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 paragraph for the year ended June 30, 2014

### 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, 2014.

### 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.



COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT	FEDERAL PROGRAM OR CLUSTER
Activities Allowed/Allowable Costs			
	2014-031	Department of Health Care Services	Medicaid Cluster Children's Health Insurance Program (CHIP) (93.767)
Matching, Level of Effort, Earmarking			
	2014-025	California Department of Education	Special Education Cluster (IDEA)
Reporting			
	2014-008	California Department of Education	Food Distribution Cluster
	2014-012	Employment Development Department	Unemployment Insurance (17.225)
	2014-018	California Department of Transportation	High-Speed Rail Corridors and Intercity Passenger Rail Services - Capital Assistance Grants (20.319) (ARRA)
	2014-019	California Department of Transportation	Transit Services Cluster Metropolitan Transportation Planning (20.505)
	2014-021	California Department of Transportation	Transit Services Cluster Formula Grants for Rural Areas (20.509)
Subrecipient Monitoring			
	2014-005	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)
	2014-009	Department of Housing and Community Development	HOME Investment Partnerships Program (14.239)
	2014-020	California Department of Transportation	Metropolitan Transportation Planning (20.505)
	2014-022	California Department of Transportation	Formula Grants for Rural Areas (20.509) Transit Services Cluster
	2014-024	California Department of Transportation	Transit Services Cluster
	2014-026	California Department of Education	Charter Schools (84.282)
	2014-032	Department of Health Care Services	Medicaid Cluster
	2014-033	Department of Public Health	HIV Care Formula Grants (Ryan White HIV/AIDS Program Part B) (93.917)
	2014-034	Department of Health Care Services	Block Grants for Community Mental Health (93.958) Block Grants for Prevention and Treatment of Substance Abuse (93.959)
Special Tests and Provisions			
	2014-006, 2014-007	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)

Our opinion on each major federal program is not modified with respect to these matters.

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 2014-003, 2014-010, 2014-015, 2014-023, 2014-028, 2014-029, and 2014-030 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 2014-002, 2014-004, 2014-005, 2014-006, 2014-007, 2014-008, 2014-009, 2014-011, 2014-012, 2014-013, 2014-014, 2014-016, 2014-017, 2014-018, 2014-019, 2014-020, 2014-021, 2014-022, 2014-024, 2014-026, 2014-027, 2014-031, 2014-032, 2014-033, and 2014-034 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  
March 19, 2015

## **Schedule of Findings and Questioned Costs**

# STATE OF CALIFORNIA SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE FISCAL YEAR ENDED JUNE 30, 2014

## Section I – Summary of Auditors’ Results

### **Financial Statements**

Issued under a separate cover. See California State Auditor’s 2014-001.1 report entitled *State of California: Internal Control and Compliance Audit Report for the Fiscal Year Ended June 30, 2014*.

### **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 SEFA noted?	No
---	----

### **Federal Awards**

Internal control over major programs:

Material weakness (es) identified?	Yes
------------------------------------	-----

Significant deficiency (ies) identified that are not considered to be material weaknesses?	Yes
--	-----

Type of auditors’ reports issued on compliance for major programs:	See below
--	-----------

**Qualification**

<b>CFDA Number</b>	<b>Federal Program or Cluster</b>
Various	Highway Planning and Construction Cluster (ARRA)
Various	Transit Services Programs 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
93.767	Children's Health Insurance Program

**Unmodified**

<b>CFDA Number</b>	<b>Federal Program or Cluster</b>
Various	SNAP Cluster
Various	Child Nutrition Cluster
Various	Food Distribution Cluster
Various	WIA Cluster
Various	Special Education Cluster (IDEA)
Various	School Improvement Grants Cluster (ARRA)
Various	TANF Cluster
10.558	Child and Adult Care Food Program
14.239	Home Investment Partnerships Program
17.225	Unemployment Insurance
17.503	Occupational Safety and Health – State Program
20.505	Metropolitan Transportation Planning
20.509	Formula Grants for Rural 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
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

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	\$114,694,753
Auditee qualified as low-risk auditee?	No

**Identification of Major Programs**

<b>CFDA Number</b>	<b>Federal Program or Cluster</b>
Various	SNAP Cluster
Various	Child Nutrition Cluster
Various	Food Distribution Cluster
Various	WIA Cluster
Various	Highway Planning and Construction Cluster (ARRA)
Various	Transit Services Programs Cluster
Various	Special Education Cluster (IDEA)
Various	School Improvement Grants Cluster (ARRA)
Various	TANF Cluster
Various	Medicaid Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
10.558	Child and Adult Care Food Program
14.239	Home Investment Partnership Program
17.225	Unemployment Insurance
17.503	Occupational Safety and Health – State Program
20.319	High-Speed Rail Corridors and Intercity Passenger Rail Services – Capital Assistance Grants
20.505	Metropolitan Transportation Planning
20.509	Formula Grants for Rural 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
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: 2014-001

### Criteria

*State Administrative Manual (SAM) Section 7974 – Year-End Report No. 13, Report of Expenditures of Federal Funds*, states that at year-end, departments will prepare a Report of Expenditures of Federal Awards, Report No. 13 (Report 13), for all federal funds

### Condition

The Department of Finance (Finance) and certain departments 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:

- Department of Health Care Services excluded \$5.1 billion of amounts passed through to subrecipients from total federal expenditures reported to Finance.
- Finance reported expenditures of approximately \$144.6 million for the State Small Business Credit Initiative Program, which was not a federal program subject to OMB Circular A-133 requirements.
- Finance reported expenditures of \$59.7 million for the Section 8 Project-Based Cluster which has a separate OMB Circular A-133 audit and should not have been reported on the Schedule.
- Finance misclassified expenditures from federal funds received from other state agencies as pass-through expenditures. These expenditures were included in total federal expenditures, and were reported again as pass-through expenditures on the Schedule. This resulted in a \$251.8 million overstatement on the Schedule.

### Department of Health Care Services Recommendations

The Department of Health Care Services should ensure that amounts passed through to subrecipients are included in total federal expenditures.

### 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 analytical procedures to identify programs that may be misclassified, missing, improperly included, or require additional analysis.

### Department of Health Care Service's View and Corrective Action Plan

Department of Health Care Services Accounting has prepared a Single Audit Report-Schedule of Expenditures of Federal Awards Report procedure to ensure the "Direct Award Expenditures" column includes the amount to subrecipients.



**Contact**

Yi-Wen Tsai, Accounting Administrator II

**Implementation Date**

March 6, 2015

**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 continue to perform additional analytical procedures of the data presented in the Schedule.

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**

July 2015

## **Schedule of Federal Award Findings and Questioned Costs**

**U.S. DEPARTMENT OF AGRICULTURE**

Reference Number:	2014-002
Category of Finding:	Subrecipient Monitoring; Reporting
Type of Finding:	Significant Deficiency

State Administering Department:	California Department of Education (Education)
Federal Catalog Number:	10.553, 10.555, 10.556, 10.559
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Years:	7CA300CA3; 2013 7CA300CA3; 2012 7CA300CA3; 2011

Federal Catalog Number:	10.558
Federal Program Title:	Child and Adult Care Food Program
Federal Award Number and Years:	7CA300CA3; 2013 7CA300CA3; 2012 7CA300CA3; 2011

**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 2012-13, we reported that the information technology controls over logical access for Education's Child Nutrition Information and Payment System (CNIPS) were not properly designed or implemented. We found the same control deficiency in the 2013-14 audit. Education uses CNIPS to calculate reimbursements to its subrecipients based on approved rates and meal counts. This system is critical to federal compliance since it is configured to calculate and submit requests to the U.S. Department of Education for reimbursement. During our audit, we noted the following:

- Although Education has a process that requires a quarterly review of CNIPS user access and check for terminated employees, it does not have a central monitoring process to ensure managers review active employee permissions.
- Education does not have a process for identifying potential segregation of duties conflicts on the CNIPS application level. 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 three users who had a state and a local account.

Failure to maintain adequate information technology controls over logical access could result in improper reimbursements through CNIPS.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Education should strengthen CNIPS IT general controls over logical access. Specifically, Education should:

1. Implement a central monitoring process to review active employee permissions.
2. Implement a process for identifying potential segregation of duties conflicts within the application.

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

Education accepts the recommendations to strengthen CNIPS information technology general controls over logical access. Education has implemented the following processes to more effectively monitor active employee permissions, as well as identify and correct any potential segregation of duties conflicts within the application:

1. Education began utilizing spreadsheets to track audit inquiries from managers and subject matter experts (SME) in April 2014. The spreadsheets include pertinent information including: (1) dates of audit inquiries; (2) manager/SME response dates; (3) response details; and (4) the names of individuals that did not respond. This centralized tracking system will allow Education to maintain a historical record of security audits and ensure that only authorized employees have CNIPS permissions

Education removed the local account permissions from the users identified by KPMG that have both state and local accounts. To ensure that there were no other active employees with multiple accounts, Education conducted a name-to-name search between state and sponsor accounts; no additional double accounts were found. In addition, under the new procedures, CNIPS will not allow a user to have multiple accounts.

2. To identify potential segregation of duties conflicts within CNIPS, Education has reviewed all security groups to identify and remove state staff permissions based on potential conflicts of interest and business needs for; (1) creating sites and sponsors; (2) approving claim submissions; and (3) changing claim tracking status.

### **Contact**

Michele Vasquez, Program Integrity Unit Manager, Nutrition Services Division

**Implementation Date**

April 2014

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Reference Number:	2014-003
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2014 7CA700CA7; 2013
Category of Finding:	Eligibility, Subrecipient Monitoring
Type of Finding:	Material Weakness 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 C – Participant Eligibility Section 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.

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's subrecipient monitoring did not ensure that local agencies policies and procedures were adequate 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 state-owned Integrated Statewide Information System (ISIS).

We tested 65 beneficiaries and found 11 instances in which at least one type of required eligibility information was not obtained or evidenced in ISIS. As a result, we could not conclude the participants were eligible to receive \$7,859 in benefits.

- For one case, the local agency noted an infant less than eight weeks old was not present at enrollment. The local agency placed a hold on the case and removed the hold three months later. There was no documentation or evidence to support removal of the hold.
- For three cases, 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 could not provide supporting eligibility information to document the participant's adjunctive eligibility through another federal program.
- For 11 cases, the local agency could not provide what form of identification verification was used to certify the participant.
- For three cases, the local agency noted no address documentation was obtained when child was certified. The local agency did not place a hold on the case and there was no evidence address documentation was eventually provided to meet the certification requirement.

Total federal expenditures paid to participants for food instruments amounted to \$763,514,478 for fiscal year 2013–14. Total benefits paid to the 65 tested participants amounted to \$53,934.

### Questioned Costs

\$7,859

### 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. Public Health should also consider additional monitoring of local agencies to ensure compliance with eligibility requirements.

## Department's View and Corrective Action Plan

Public Health concurs with the findings. Public Health/WIC Division will determine the feasibility of making changes to ISIS to categorize specific fields as mandatory so local agency staff cannot move forward without completing the appropriate documentation. Public Health/WIC Division will make changes to its internal processes for monitoring local agency contractors to strengthen compliance. Public Health/WIC Division will determine the feasibility of creating a quarterly report of participant ISIS "holds" and other information that may provide the opportunity for enhanced monitoring and focused technical assistance to local agency contractors that appear to have holds in ISIS records beyond the acceptable timeframes. Public Health/WIC Division will also review and update the tools used for monitoring local agencies to prioritize eligibility criteria. Lastly, Public Health/WIC Division will issue written communication to local agency contractors to reiterate the importance of correctly documenting all participant eligibility determinations in ISIS and host two training webinars for local agency contractors that will be focused on WIC eligibility determination and proper documentation.

## Contact

Barbara Longo, Deputy Chief, Nutrition and Local Program Services

## Implementation Date

Written communication to local agency contractors – March 16, 2015

Webinar trainings for local agency contractors – April 21, 2015

Creation of new monitoring reports – June 30, 2015

Monitoring tool update – June 30, 2015

Changes to ISIS fields – July 31, 2015

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Reference Number:	2014-004
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Year:	7CA700CA7; 2014 7CA700CA7; 2013
Category of Finding:	Eligibility; Reporting
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Public Health (Public Health)

## Criteria

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

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

*State Administrative Manual*, Section 5300 – Information security 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, 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 2012–13, we reported the information technology (IT) controls over logical access for the Integrated Statewide Information System (ISIS) were not properly designed and implemented. In fiscal year 2013–14, we also found certain IT controls over logical access were not properly designed and implemented. Public Health utilizes ISIS to determine eligibility for WIC participants as well as to monitor and report issuance and redemption of food vouchers. IT general controls should be properly designed and operating effectively to help ensure application controls function properly.

Specifically, we identified the following:

- Public Health granted an unapproved level of access to two of 25 users tested.
- Public Health did not properly terminate access to ISIS for 10 of the 377 individuals with access to ISIS that had been terminated and, therefore, should no longer have access to the system.
- Public Health did not formally document the annual user access review. Additionally, this review does not include a review of users' key roles and permissions.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Public Health should improve its policies and procedures over logical access. Specifically, Public Health should:

1. Ensure that individuals are granted the appropriate level of access.
2. Identify individuals who have been terminated and promptly remove their access.
3. Formally document the annual user access review and enhance this review to include a review of users' key roles and permissions.



## Department's View and Corrective Action Plan

Public Health concurs with the findings.

Public Health/WIC Division will issue a policy and procedure memo to reiterate existing instructions to WIC local agency contractors regarding the responsibilities of the local agencies to ensure ISIS user account security. These instructions will include the appropriate level of access to ISIS, removal of ISIS access to staff who have changed jobs or are no longer employed with the local agency, creation of reports to identify ISIS users for monthly reconciliation, and refreshing of instructions for ISIS password requirements. In addition, Public Health/WIC Division will update its semi-annual reporting template to require local agency contractors to verify that they have reviewed ISIS access and that access has been removed for terminated staff.

Public Health/WIC Division will review monthly ISIS reports and verify that state staff identified still engage in activities that require ISIS access as part of their essential functions. Public Health/WIC will incorporate ISIS access verification as part of the exit process for terminated state employees. Public Health/WIC will also participate in the annual user account review by verifying state staff's key roles and permissions with Public Health/WIC management in order to ensure appropriate levels of access.

## Contact

Lisa Kawano, Assistant Chief, Women, Infants and Children (WIC) Division

## Implementation Date

Local Agency Memo - February 27, 2015

Semi-annual reporting template – March 31, 2015

State exit process – March 31, 2015

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Reference Number:	2014-005
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2014 7CA700CA7; 2013
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, 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 have adequate controls in place to ensure notices of audit findings were issued within 90 days of completion of a financial management review. Financial management reviews are performed to ensure that cost reimbursement claims made by local agencies comply with the applicable cost principles and include a review of the local agency's financial management system and cost allocations for direct and indirect costs. We tested eight financial management reviews performed in fiscal year 2013–14 and found that two had findings that required issuance of a notice of audit findings to the local agency. However, Public Health did not issue the notice of audit finding within the 90 days due to program staff believing that the legal department had placed a hold on issuing these notices. No legal hold had been placed. Failure to issue findings in a timely manner increases the risk that local agencies may utilize federal funds for unallowable costs and activities.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Public Health should work with its legal department to resolve any matters impacting the issuance of audit findings so that notices are issued within 90 days of completion of a financial management review.

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

Public Health concurs with the findings. The two letters of findings that were issued beyond the 90 day time period were the result of a miscommunication within Public Health/WIC Division regarding staff's understanding regarding advice provided by Public Health Office of Legal Services. All staff involved in the issuance of audit findings letters have been advised that there is no "hold" placed on issuance of audit findings letters. In addition, Public Health/WIC Division will centralize its audit coordination and response functions to ensure appropriate oversight and follow up on all audit findings and resulting actions. Currently, responsibility for follow up of findings resides in a variety of programmatic areas. Centralizing the various audit coordination and response functions will strengthen communication, oversight, follow up, and reporting.

### **Contact**

Lisa Kawano, Assistant Chief, Women, Infants and Children (WIC) Division

### **Implementation Date**

Miscommunication clarification for staff - January 2015  
Create centralized audits unit – June 30, 2015

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Reference Number:	2014-006
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2014 7CA700CA7; 2013
Category of Finding:	Special Tests and Provisions
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 E—State Agency Provisions, § 246.12 Food delivery systems.

- (r) Retail purchase systems
- (5) The State agency shall establish procedures to ensure the propriety of redeemed food instruments.
  - (i) The State agency shall design and implement a system of review of food instrument to detect suspected overcharges and to identify food vendors with high levels of suspected overcharges. (ii) The State agency shall design and implement a system of review of food instruments to detect errors, including, at least, purchase price missing, participant signature missing, vendor identification missing, redemption by vendor outside of the valid date and, as appropriate, altered prices. The State agency shall implement procedures to reduce the number of errors, where possible.

**Condition**

Public Health did not have adequate controls in place to ensure that food instruments redeemed by vendors conform to program regulations. In its representative sample of food instruments reviewed for amounts that exceeded the maximum monetary purchase amount or other errors, such as an altered purchase price, Public Health did not appropriately report and follow up on certain food instruments. We tested 65 food instruments reviewed by Public Health and identified three food instruments where the review appropriately identified an altered purchase price; however, Public Health did not appropriately include these food instruments as errors in its 2013 WIC Food Instrument Audit Report. Of the three food instruments identified, one was appropriately investigated to determine whether or not an improper payment was made; however, no follow-up was performed on the remaining two food instruments identified. Improper reporting and follow-up on food instruments with altered purchase price increases the risk that vendors inappropriately redeem food instruments, and the state will not reclaim monies owed.

**Questioned Costs**

No specific questioned costs were identified.

## Recommendations

Public Health should implement a process to ensure follow up is made on findings identified during food instrument reviews and such findings are properly reported in the WIC Food Instrument Audit Report.

## Department's View and Corrective Action Plan

Public Health concurs with the findings. The spreadsheet used by Public Health/WIC Division to document whether a vendor submitted a Food Instrument (FI) with an error or not has been modified to add a formula to automatically calculate the total number of errors identified for each FI. The calculating formula has been added to the FI audit spreadsheet template and will be utilized for the 2014 FI Audit process.

## Contact

Susan Sabatier, , Chief, Data Analysis, Research and Evaluation Section

## Implementation Date

Template modification – September 8, 2014

Recalculated 2013 FI Audit Findings – September 8, 2014

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Reference Number:	2014-007
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2014 7CA700CA7; 2013
Category of Finding:	Special Tests and Provisions
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 E—State Agency Provisions, § 246.12 Food delivery systems.

(j) Retail food delivery systems: Monitoring vendors and identifying high-risk vendors –

- (4) Compliance investigations. (i) High-risk vendors. The State agency must conduct compliance investigations of a minimum of five percent of the number of vendors authorized by the State agency as of October 1 of each fiscal year. The State agency must conduct compliance investigations on all high-risk vendors up to the five percent minimum. The State agency may count toward this requirement a compliance investigation of a high-risk vendor conducted by a Federal, State, or local law enforcement agency. The State agency also may count toward this requirement a compliance investigation conducted by another WIC State agency provided that the State agency implements the option to establish State agency sanctions based on

mandatory sanctions imposed by the other WIC State agency, as specified in paragraph (l) (2)(iii) of this section. A compliance investigation of a high-risk vendor may be considered complete when the State agency determines that a sufficient number of compliance buys have been conducted to provide evidence of program noncompliance, when two compliance buys have been conducted in which no program violations are found, or when an inventory audit has been completed.

(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 properly monitored high risk vendors and took appropriate action on findings identified during vendor inventory audits. In fiscal year 2013–14, Public Health conducted 158 vendor inventory audits. However, Public Health did not issue a notice of audit finding within 90 days of completion of the audit for 13 of 30 compliance investigations tested due to program staff believing that the legal department had placed a hold on issuing these notices. No legal hold had been placed. As of June 30, 2014, eight of 13 notice of audit finding letters had been issued to vendors and the collection process had begun. The remaining five notice of audit finding letters were issued subsequent to June 30, 2014. Additionally, Public Health did not evidence its review of five of 35 undercover compliance buys tested. Failure to issue notices of audit findings on compliance investigations and failure to properly review compliance buy audits increases the risk that vendors inappropriately redeem food instruments and the state will not reclaim monies owed.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Public Health should adhere to 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. Additionally, Public Health should strengthen controls over compliance buys to ensure they are properly reviewed.

### Department's View and Corrective Action Plan

Public Health concurs with the findings. Currently, on a bi-weekly basis, Public Health/WIC Division is monitoring the vendor inventory audit report for the update and status of vendors that have audit findings. This review is a cross-check to ensure that letters are being issued timely.

To verify that compliance buys are properly reviewed, Public Health/WIC Division will implement an "Internal Management Quality Assurance File Review Checklist" form. Public Health/WIC management will use this form to conduct random monthly samples to review vendor compliance buys resulting in a "no findings" or "minimal findings" status. Additionally, a "Compliance Monitoring Investigation File Peer Review Checklist" form will be developed for management to complete a review when compliance investigations have been conducted and results in findings that lead to a vendor termination and/or disqualification.

In addition, Public Health/WIC Division will centralize its audit coordination and response functions to ensure appropriate oversight and follow up on all audit findings and resulting actions. Currently, responsibility for follow up of findings resides in a variety of programmatic areas. Centralizing the various audit coordination and response functions will strengthen communication, oversight, follow up, and reporting.

## Contact

Sharon G. Lindner, Chief, Vendor Integrity Section

## Implementation Date

Vendor Inventory Audit Report – August 4, 2014

Internal Management Quality Assurance File Review Checklist – March 30, 2015

Compliance Monitoring Investigation File Peer Review Checklist – March 30, 2015

Create centralized audits unit – June 30, 2015

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Reference Number:	2014-008
Federal Catalog Number:	10.565
Federal Program Title:	Commodity Supplemental Food Program
Federal Award Number and Years:	7CA300CA3; 2014 7CA810CA1; 2013
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 – *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.

TITLE 7 – AGRICULTURE, PART 247 – COMMODITY SUPPLEMENTAL FOOD PROGRAM,  
§ 247.29 Reports and recordkeeping.

- (2) FNS-153, Monthly Report of the Commodity Supplemental Food Program and Quarterly Administrative Financial Status Report. The State agency must submit the FNS-153 on a monthly basis. FNS may permit the data contained in the report to be submitted less frequently, or in another format. The report must be submitted within 30 days after the end of the reporting period. On the FNS-153, the State agency reports:
- (i) The number of program participants in each population category (e.g., infants, children, and elderly);
  - (ii) The receipt and distribution of commodities, and beginning and ending inventories, as well as other commodity data; and
  - (iii) On a quarterly basis, the cumulative amount of administrative funds expended and obligated, and the amount 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 three FNS-153 reports tested, resulting in a net understatement of \$1,385,075 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. The primary purpose of Food and Nutrition Service (FNS)-153 reporting is to inform the United States Department of Agriculture (USDA) of: 1) the amount of Commodity Supplemental Food Program (CSFP) funding released to the local agencies; and 2) 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 revert 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."

To ensure the accuracy of FNS-153 reports, Education strengthened internal controls which include the following data review and validation procedures:

- The Local Agency reports are combined into a single state report by two Education CSFP staff members; one staff member reviews the inventory information, another staff member 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 data reporting errors. The errors are corrected, the warnings considered, and another Engine Validation report is produced to ensure the correction of all errors.

- Copies of the FNS-153 reports and all back-up documentation are submitted to the CSFP manager for final review and approval. The manager certifies the FNS-153 report submission in the FPRS and sends an e-mail to the USDA confirming the review and certification.

After the FNS-153 reports are submitted to the USDA, the USDA confirms the sufficiency and acceptance of the reports via e-mail.

### **Contact**

Jacqueline Henderson, Manager, Distribution and Processing Unit, Nutrition Services Division

### **Implementation Date**

July 1, 2015



**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

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Reference Number:	2014-009
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**

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**

HCD 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 four of 11 audit reports with HOME Program 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**

HCD should strengthen its policies and procedures to ensure that management decisions are issued within six months after receipt of a subrecipient's OMB Circular A-133 audit report.

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

HCD will ensure that a HOME A-133 subrecipient audit finding tracking system is kept up to date, either in CAPES or in an Excel file stored in the DFA group drive. The staff or Manager responsible for sending out the management letters will keep this report up to date. The responsible person's supervisor

will check the report monthly to ensure that the management letters are going out within six months. If not, the responsible person's supervisor will adjust their priorities to allow time for the letter to go out or will delegate as necessary to other HCD employees.

**Contact**

Tom Bettencourt, Branch Chief, HOME Investment Partnerships Program

**Implementation Date**

June 30, 2015

**U.S. DEPARTMENT OF LABOR**

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Reference Number:	2014-010
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance (UI)
Federal Award Number and Years:	UI-23881-13-55-A-6, 2014 UI-22264-12-55-A-6, 2013
Category of Finding:	Eligibility
Type of Finding:	Material Weakness
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.

**Condition**

EDD does not have a process in place to reconcile the UI benefit expenditures raw data extract provided for eligibility testing, to its general ledger system. UI claimant expenditure detail is maintained within EDD's Single Client Database (SCDB) system and the variance between the raw data provided and the general ledger was approximately \$600 million. Upon our request, EDD reconciled the claimant expenditures in SCDB to amounts reported in the general ledger. EDD did not reconcile this data throughout the year and took six months to complete the reconciliation for fiscal year 2013-14. Failure to reconcile claimant expenditures to the general ledger may result in errors in amounts reported in their general ledger and to the Federal government.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

EDD should implement a reconciliation process over claimant expenditures raw data from SCDB to amounts reported in the general ledger.

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

The EDD complied with the criteria cited for this finding. Specifically, the EDD has internal controls over federal programs to ensure compliance with applicable federal laws, regulations, and contract and grant agreements. The EDD maintains controls to ensure the amounts recorded in the general ledger and reported to the federal government are accurate. The controls include weekly, monthly, and year-end processes which consist of reconciling claimant expenditures from the Single Client Data Base and other related systems (e.g., Accounting and Compliance Enterprise System [ACES], and Benefit

Accounting System). Therefore, these processes would identify any discrepancies before the amounts are reported to the federal government. This was further validated, as the KPMG audit did not disclose deficiencies with management of federal monies.

The condition as stated by KPMG appears to refer to the “raw” data extract initially provided to their auditors, which does not relate to the criteria cited for this finding. The challenge encountered was that the initial extract provided to the auditors only included the payments portion of the raw data. This is the extract from which the KPMG auditors have historically pulled their test work. Subsequently, our understanding of what the auditors were requesting was to ensure that the raw data provided reconciled directly to the general ledger (Report of Expenditures of Federal Funds [Report No. 13]). This required extensive work since there are various data sources that provide the raw data that make up the expenditures recorded in the general ledger for Report No. 13, not just the payments portion of the data.

To reconcile the general ledger to the raw data extract for KPMG, we had to define the expenditure types (e.g., overpayments, paper warrants, electronic benefit transfers, combined wages to and from other states, federal income tax withholdings, and extension expenditures) generated from each subsystem within each business unit. These expenditures made up the majority of the difference from the initial data extract. Subsequently to defining the expenditure types, we had to identify the computer programmers that could write the computer programs to extract the data from each subsystem. Once the computer programs were written and the data was extracted, each business unit had to verify that the individual claimant expenditures reported for Fiscal Year 2013-14, were included in the extract. In addition, research had to be conducted to identify whether other expenditures were missing or the computer program had to be revised.

The EDD recognizes the importance of providing accurate information to the auditors for testing and has developed a process to ensure data extracts are reconciled to the general ledger before the information is released to the auditors. As of December 15, 2014, the EDD has computer programs readily available for future audits that will extract detailed claimant expenditure data from multiple subsystems to provide the auditors with the universe of claimant expenditures for a given fiscal year. In addition, the Fiscal Programs Division will work with the Information Technology Branch and other business units who provide claimant expenditures to ensure data extracts provided to auditors agree with the general ledger and Report No. 13.

## **Contact**

Cathy Barratt, Unemployment Insurance Branch, Policy and Coordination Division

## **Implementation Date**

December 2014

## **Auditors' Conclusion**

The condition within the finding does not comment on the management of federal monies. EDD acknowledges that the request for the raw data extract has historically been made and is necessary for audit purposes. While we identified reconciling matters in the prior year audits, the variance between the raw data and general ledger was \$600 million in fiscal year 2013-14 and the effort needed by EDD this year to resolve the difference was significantly greater than in prior years. As a result, we concluded that the controls are not operating effectively to reconcile detailed claimant data to the general ledger.

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Reference Number:	2014-011
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance (UI)
Federal Award Number and Years:	UI-23881-13-55-A-6, 2014 UI-22264-12-55-A-6, 2013
Category of Finding:	Eligibility
Type of Finding:	Significant Deficiency
State Administering Department:	Employment Development Department (EDD)

## Criteria

TITLE 20 EMPLOYEES' BENEFITS, CHAPTER V – EMPLOYMENT AND TRAINING  
ADMINISTRATION, DEPARTMENT OF LABOR, Part 602 – Quality Control in the Federal-State  
Unemployment Insurance System, Subpart B – Federal Requirements, Section 602.11 – Secretary's  
Interpretation

- (a) The Secretary interprets section 303(a)(1), SSA, to require that a State law provide for such methods of administration as will reasonably ensure the prompt and full payment of unemployment benefits to eligible claimants, and collection and handling of income for the State unemployment fund (particularly taxes and reimbursements), with the greatest accuracy feasible.

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

EDD uses the Single Client Data Base (SCDB) system to handle claims intake, processing, eligibility determination, and payment of unemployment insurance claims. The SCDB was designed with various edit checks and application controls to promote segregation of duties and ensure proper eligibility determinations and claims processing. EDD had established global security patterns within the SCDB so that claim processors who had access to initiate payments could not file claims and vice versa. Edit

checks were also implemented to stop benefit payments if continuing eligibility requirements allowing claimants to receive their benefits were not met. EDD staff worked to manually clear these edit checks, if appropriate, in order to process the claim for payment.

In September 2013, EDD implemented the California Unemployment Benefits Payment System (CUBS) to add functionality to its unemployment processing system, the SCDB. CUBS has built-in logic to determine whether a claimant is eligible for payment (based on information obtained from the SCDB), calculate and process benefit payments, and authorize the payment.

In fiscal year 2013-14, we noted that EDD had not yet established the policies to address which users are authorized to have certain permissions within CUBS that would ensure a proper segregation of duties. EDD determined that staff with the ability to file claims in SCDB also had the ability to create weekly certifications that are required for CUBS to determine claimant eligibility. Providing staff with the permission to file claims in SCDB and the permission to create weekly certifications in CUBS constitutes a lack of segregation of duties within the eligibility process which could result in a payment to a claimant who was not deemed eligible.

Failure to maintain adequate information technology controls could result in improper eligibility determinations and benefit payments.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

EDD should establish permissions within CUBS that promote segregation of duties within the claim filing process. Specifically, the permission should prevent staff with the ability to file claims from creating weekly certifications.

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

We understand the necessity of establishing permissions within CUBS that promote separation of duties within the claim filing process; specifically, that the permissions should prevent staff with the ability to file claims from creating weekly certifications. Since the implementation of CUBS, we have been working on mapping the CUBS permissions to SCDB global security patterns in order to establish our CUBS global security policies to ensure proper separation of duties. Beginning in April 2014, for staff with SCDB claim filing authority, we began revoking the CUBS permission that allowed them to create the weekly certifications. As of mid-August 2014, we have identified all affected claim filing staff and removed their permission to create weekly certifications. Since August 2014, we have been doing periodic checks to make sure that staff with SCDB Claim Filing authorization do not also have access to create weekly certifications.

### **Contact**

Cathy Barratt, Unemployment Insurance Branch, Policy and Coordination Division

### **Implementation Date**

August 2014

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Reference Number:	2014-012
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance (UI)
Federal Award Number and Year:	UI-23881-13-55-A-6, 2014
Category of Finding:	Reporting
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 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.

ETA 2208A, *Quarterly UI Contingency Report* (OMB No. 1205-0132) – Quarterly report of staff years worked and paid by program category. Key line items are 1 through 7 of Section A.

## Condition

EDD does not have adequate controls in place to evidence its review of the ETA 2208A, *Quarterly UI Contingency Report*. In addition, EDD did not properly reconcile the underlying detail to the report, and as a result, for the two ETA 2208A reports tested, EDD did not accurately report the number of Staff Years Paid for program categories Claims Activities, Employer Activities, UI Performs, and Support AS&T. 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

EDD should strengthen its process over reconciliation and review of ETA 2208A reports to ensure accuracy of the reports prior to submission.

## Department's View and Corrective Action Plan

The EDD currently has a process in place that includes a review and a reconciliation of the underlying detail to the ETA 2208A report. This process has been modified to ensure documentation of all ETA 2208A report reviews are in writing (via email).

Although EDD agrees that errors in the tested report existed, we disagree that it was due to failure to reconcile reports to supporting documents. All detail behind the data that is included in the ETA 2208A is meticulously reconciled with workload reports, cost accounting reports, and invoice reports each quarter. The errors were a result of a complication in backup worksheets used to consolidate the report data. The complication in the methodology involved the fact that backup files collected staff years worked and paid data on separate sheets, where activity codes were categorized into Department of Labor workload types independently of each other. This increased the possibility that the same activity codes could potentially be placed into different categories on each sheet if a link was inadvertently changed due to human error. The EDD does not produce any reports that would facilitate reconciliation of staff years by Department of Labor workload category. Although activity code categorization is researched and reviewed for accuracy when a new activity code is created, the worksheet links are not re-verified each quarter, as they should remain the same throughout the lifetime of the coding.

The EDD has improved the methodology used to categorize staff years worked and paid to ensure activity codes are not placed in more than one category. KPMG tested reports that were submitted prior to an update in reporting methodology that was completed in the fall of 2014 and implemented beginning with the ETA 2208A for the quarter ending December 31, 2014. The new methodology has simplified the worksheet for collecting data, which now utilizes an Excel “lookup” formula for both staff years worked and paid using the same reference table to categorize both, eliminating the possibility of the same type of errors that were discovered by KPMG.

The EDD would like to note that for the two ETA 2208A reports that KPMG tested, quarter ending December 31, 2013 and quarter ending June 30, 2014, the discrepancies found in the Claims Activities Staff Years Paid resulted in the EDD receiving \$34,855 less than it should have received in above base earnings for those two quarters, which equates to 0.09 percent of the \$37.2 million in total funding received for those two quarters (less postage and other).

## Contact

Laura Jacobson, Administration Branch, Fiscal Division, Staff Services Manager

## Implementation Date

Fall 2014

## Auditors' Conclusion

In the two instances noted, our audit detected the errors in the ETA 2208A report by recalculating amounts and reconciling to underlying data. Further, under the provisions of the March 2014 OMB Circular A-133 *Compliance Supplement*, we are required to test key line items 1 through 7 of Section A of the ETA 2208A report, which reports number of staff-year usage. Therefore we did not comment on the dollar amount of the discrepancies.



**U.S. DEPARTMENT OF TRANSPORTATION**

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Reference Number:	2014-013
Federal Catalog Number:	20.205 (ARRA)
Federal Program Title:	Highway Planning and Construction Cluster (Highway Planning)
Federal Award Number and Year:	N 4510.765; 2013 N 4510.758; 2012
Category of Finding:	Special Tests and Provisions
Type of Finding:	Significant Deficiency and Material Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

**Criteria**

TITLE 23 – HIGHWAYS, CHAPTER I – FEDERAL HIGHWAY ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, SUBCHAPTER G – ENGINEERING AND TRAFFIC OPERATIONS, Part 637, Construction Inspection and Approval, Section 207 - Quality Assurance Program

- (a) (3) 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**

During our audit for fiscal year 2012-13, we reported that Caltrans did not have adequate controls in place to ensure required materials certifications were prepared. The materials certifications are required by federal regulation and provide evidence that proper tests were performed in accordance with the approved Caltrans quality assurance program. In July 2009, Caltrans implemented procedures to obtain materials certifications for projects accepted after this date. We tested 53 projects both prior and subsequent to July 2009 since the regulation has been in place prior to 2009. We found that Caltrans was unable to locate materials certifications for nine projects accepted prior to July 2009 and one project accepted after July 2009. 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 strengthen its procedures 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. Prior to July 2009, the Caltrans Construction Manual instructed resident engineers to prepare a memorandum for project materials acceptance. Form CEM-6302 was created in July 2009 for documentation of project materials acceptance. 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. For this audit, the materials memorandum or certification was not located for 10 projects. Of the 10 projects without a materials memorandum or certificate, all but one project was accepted prior to July 2009. As a result, the Division of Construction is aware that this may continue to be a challenge on projects accepted prior to July 2009. On October 24, 2013, a construction policy directive was issued to remind staff of the importance of project documentation at project completion. Construction is editing the *Construction Manual* to clarify the list of documents to be maintained in the project history file required for permanent records retention. Staff are informed of changes to the *Construction Manual* through a construction policy bulletin. Caltrans will continue to inform staff when changes to record retention policies occur through updates to the *Construction Manual*.

## Contact

John Bittermann, Senior Engineer, Division of Construction

## Implementation Date

June 30, 2015

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Reference Number:	2014-014
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-0121-12-01-00; 2012 FR-HSR-0117-12-01-00; 2011 FR-HSR-0116-12-01-00; 2011 FR-HSR-0108-12-01-00; 2011 FR-HSR-0107-12-01-00; 2011 FR-HSR-0106-12-01-00; 2011 FR-HSR-0100-11-01-00; 2011 FR-HSR-0092-11-01-00; 2011 FR-HSR-0091-11-01-00; 2011 FR-HSR-0068-11-01-00; 2011 FR-HSR-0058-11-01-00; 2011 FR-HSR-0045-11-01-00; 2011 FR-HSR-0032-11-01-00; 2011 FR-HSR-0022-11-01-00; 2011 FR-HSR-0021-11-01-00; 2011
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 18 draws and found no evidence of review of eight of the draws prior to submission. Failure to maintain adequate controls increases the risk that Caltrans may draw 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

A reminder memorandum will be sent to staff regarding the review and signature of cash drawdown requests by first line supervisors or managers prior to submittal in FRA's electronic invoice submittal system (eInvoice). Contract managers will be reminded to retain this evidence of review in the project file.

### Contact

Crystal Ortiz, Division of Rail and Mass Transportation

### Implementation Date

April 30, 2015

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Reference Number:	2014-015
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-0058-11-01-01; 2011 FR-HSR-0022-11-01-00; 2011 FR-HSR-0021-11-01-01; 2011
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

During our audit for fiscal year 2012-13, we reported that Caltrans did not have procedures in place to comply with federal Davis-Bacon Act requirements because it did not obtain certified weekly payrolls from contractors for the High Speed Rail program. In fiscal year 2013-14, Caltrans had not yet implemented procedures to obtain the weekly certified payrolls. Failure to obtain the required weekly certified payrolls increases the risk of noncompliance with Davis-Bacon Act requirements.

## Questioned Costs

Not determined.

## Recommendations

Caltrans should implement procedures to obtain the weekly required certified payrolls.

## Department's View and Corrective Action Plan

Caltrans currently has approved Davis-Bacon compliance language. For future contracts, Caltrans Legal will determine Davis-Bacon applicability and this determination will be documented in the project file. For future contracts under which Davis-Bacon does apply, Caltrans will ensure that the appropriate language is included in the contract and weekly certified payrolls will be required to be submitted by the contractor with their invoice reimbursement requests.

Caltrans Legal is in the process of reviewing all existing contracts to determine the applicability of Davis Bacon provisions and whether the proper language was included in the contracts if Davis-Bacon does apply. Once it is determined which contracts require Davis-Bacon, and that the proper language was included in the contract, contract managers will notify the contractor to submit weekly certified payrolls.

Caltrans Legal has completed its review of the contract funded by Grant number FR HSR 0022 11-01-00. Legal determined that Davis-Bacon does apply but that the contract did not contain Davis-Bacon compliance language. Caltrans will seek to amend this contract to add the Davis-Bacon requirement. If the contractor does not agree to amend, Caltrans will not be able to require submission of certified weekly payrolls.

Regarding the status of the remaining two grants, the contract for Grant number FR-HSR-0058-11-01-01 was completed as of August 31, 2014 and is in the process of closeout with FRA. Further, Caltrans Legal is still in the process of reviewing the contract for Grant number FR-HSR-0021-11-01-01.

## Contact

Crystal Ortiz, Division of Rail and Mass Transportation

## Implementation Date

June 30, 2015

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Reference Number:	2014-016
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-0009-10-01-05; 2010
Category of Finding:	Davis-Bacon Act
Type of Finding:	Significant Deficiency
State Administering Department:	California High Speed Rail Authority (Rail Authority)

## Criteria

TERMS AND CONDITIONS OF THE GRANT/COOPERATIVE AGREEMENT BETWEEN UNITED STATES DEPARTMENT OF TRANSPORTATION – FEDERAL RAILROAD ADMINISTRATION AND THE CALIFORNIA HIGH-SPEED RAIL AUTHORITY

## Attachment 2; General Provisions, Subpart 6b—Audit and Inspection

### (1) General Audit Requirements: A Grantee that is:

- a. A State, local government or Indian tribal government agrees to comply with the audit requirements of 49 CFR 18.26 and OMB Circular A-133, and any revision or supplement thereto.

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 that could have a material effect on each of its Federal programs.

U.S. OFFICE OF MANAGEMENT AND BUDGET A-133 COMPLIANCE SUPPLEMENT; PART 6 – INTERNAL CONTROL; General Guidance – Internal Control Over Compliance For Major Programs With Expenditures of ARRA Awards

Section 1 – It is essential that auditee management establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements, including internal controls designed to ensure compliance with ARRA requirements. The auditor then performs and documents testwork relating to internal controls as required by OMB Circular A-133.

Section 3 – At many entities, awards funded by ARRA funds will result in material increases in funding, which may result in a material increase in the level of resources needed by management to properly manage, monitor, and account for Federal awards and effectively operate internal control. As part of the consideration for internal control over compliance, auditors should consider “capacity” issues as follows:

- When evaluating whether identified control deficiencies, individually or in combination, are significant deficiencies or material weaknesses, the auditor should consider the likelihood and magnitude of noncompliance. One of the factors that affects the magnitude is the volume of activity exposed to the deficiency in the current period or expected in the future.

## Condition

During fiscal year 2013-14, the California High Speed Rail Authority (Rail Authority) began construction on the first segment of its high speed rail system. During the audit, we tested for compliance with the Davis-Bacon Act and found that the Rail Authority complied with these requirements. However, our review noted that the Rail Authority lacked finalized and documented procedures designed to detect or prevent noncompliance with Davis-Bacon Act requirements. As the Rail Authority increases construction activity in the future on other segments of its high speed rail system, having a written, formalized process will better enable it to monitor compliance with the Davis-Bacon Act and ARRA requirements. The Rail Authority’s contract compliance and small business administrator acknowledged that his agency did not yet have an official/finalized process. However, to its credit, the Rail Authority is in the process of developing procedures in its Labor Compliance Operating Manual and provided the audit team with a draft of such procedures during the audit. The Rail Authority needs to finalize and distribute such procedures to its staff.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

To ensure that its staff are properly monitoring its contractors for compliance with the Davis-Bacon Act, the Rail Authority should finalize and implement internal controls to prevent and detect potential noncompliance.

## Department's View and Corrective Action Plan

The Authority does have, and has been using, a draft version of the procedures designed to detect and/or prevent noncompliance. The Authority acknowledges that it does not have a finalized procedure regarding internal controls to prevent and detect potential noncompliance. It is a priority of the Authority to adopt procedures before construction activities increase to guarantee an effective compliance program. The draft version of this procedure can be found in the Authority's Labor Compliance Operating Manual (manual). The Authority will finalize and formally adopt this manual by June 30, 2015. The Authority, its staff and representatives, will continue using the draft manual until it is finalized to ensure proper compliance monitoring of its contractors with the Davis-Bacon Act.

## Contact

Paula Rivera, California High-Speed Rail Authority, Audit Division, Senior Management Auditor

## Implementation Date

June 30, 2015

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Reference Number:	2014-017
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-0009-10-01-05; 2010
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency
State Administering Department:	California High Speed Rail Authority (Rail Authority)

## Criteria

TITLE 49—TRANSPORTATION—SUBTITLE A—OFFICE OF THE SECRETARY OF  
TRANSPORTATION—PART 18—UNIFORM ADMINISTRATION REQUIREMENTS FOR  
GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS

§18.20 Standards for financial management systems.

- (a) A state must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to—

- (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and



- (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULATOR 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 that could have a material effect on each of its Federal programs.

## Condition

Although we found that the Rail Authority reported accurate financial information on the SF-425 report, it lacks adequate internal controls to ensure that the SF-425 captures all relevant spending information. Specifically, the Rail Authority's financial grant administrator told us that she uses a manual process to track federal financial data in an internally developed Excel workbook (workbook) and uses this workbook as the basis of preparing the SF-425 report. However, we noted that the Rail Authority lacked procedures to ensure that its workbook was accurate and complete when compared to its official accounting records. Although the financial grant administrator stated that Rail Authority staff review the California State Accounting and Reporting System (CALSTARS) and the state controller's financial data when entering financial transactions into the workbook, she does not compare the financial information reported in the SF-425 reports to the Rail Authority's official accounting records before submitting the report to the Federal Railroad Administration. Further, the Rail Authority's financial officer told us that his review consists of comparing the SF-425 reports to the workbook and not with the State's financial records. As a result, it is not clear how the Rail Authority's management would identify errors or omissions in its workbook and we believe it would be prudent for the Rail Authority to at least compare the amounts reported on the SF-425 to its official accounting records prior to submission.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

The Rail Authority needs to develop procedures to verify that the amounts reported on the SF-425 are consistent with its official accounting records prior to submission.

## Department's View and Corrective Action Plan

We concur with this finding. The Authority Fiscal Services Division (FINO) has developed a policy to ensure that all amounts are compared to its official accounting record. FINO has also implemented procedures for comparing amounts reported on the SF-425 to the accounting records prior to submission.

## Contact

Paula Rivera, California High-Speed Rail Authority, Audit Division, Senior Management Auditor

## Implementation Date

March 3, 2015



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Reference Number:	2014-018
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-0121-12-01-00; 2012 FR-HSR-0117-12-01-00; 2011 FR-HSR-0116-12-01-00; 2011 FR-HSR-0108-12-01-00; 2011 FR-HSR-0107-12-01-00; 2011 FR-HSR-0106-12-01-00; 2011 FR-HSR-0100-11-01-00; 2011 FR-HSR-0092-11-01-00; 2011 FR-HSR-0091-11-01-00; 2011 FR-HSR-0068-11-01-00; 2011 FR-HSR-0058-11-01-00; 2011 FR-HSR-0045-11-01-00; 2011 FR-HSR-0032-11-01-00; 2011 FR-HSR-0022-11-01-00; 2011 FR-HSR-0021-11-01-00; 2011
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

During our audit for fiscal year 2012-13, we reported that Caltrans did not have adequate controls in place over FFRs (SF-425) submitted for the High Speed Rail program. In fiscal year 2013-14, Caltrans did not accurately report the federal share of expenditure for five of the nine SF-425 reports tested, resulting in a net understatement of \$358,747 of federal expenditures. In addition, for all nine reports, Caltrans reported errors in various other line items. Failure to maintain and 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 review and reconciliation of SF-425 reports to ensure accuracy of the reports prior to submission.

## Department's View and Corrective Action Plan

In March 2014, Caltrans Division of Rail and Mass Transportation (DRMT) received new guidance from the Federal Railroad Administration (FRA) on the way to correctly complete the SF 425 report. The new guidance was distributed to staff and was implemented on subsequent reports beginning with the April 2014 - June 2014 reporting period. Additionally, DRMT will work with the Division of Accounting to ensure that the proper expenditure reports are used to calculate amounts for the SF-425. A reminder memorandum will be sent to staff with the FRA guidance and the requirement that SF-425s be reviewed and signed by first-line supervisors or managers. Contract managers will be reminded to retain supporting documentation and evidence of review in the project file.

## Contact

Crystal Ortiz, Division of Rail and Mass Transportation

## Implementation Date

August 31, 2015

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Reference Number:	2014-019
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)
Federal Catalog Number:	20.513, 20.516, 20.521
Federal Program Title:	Transit Services Cluster
Federal Award Number and Year:	CA-16-0057-00; 2012 CA-37-X166-00; 2012 CA-57-X085-00; 2012 CA-16-0055-00; 2010 CA-37-X128-00; 2010 CA-37-X131-00; 2010 CA-57-X053-00; 2010

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Federal Catalog Number:	20.505
Federal Program Title:	Metropolitan Transportation Planning
Federal Award Number and Year:	CA-81-0011-00; 2014 CA-81-0010-00; 2013

## 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

Caltrans did not have a process in place to comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for the Metropolitan Transportation Planning program and the Transit Services Cluster. As a result, the information required under FFATA was not submitted for any of the first-tier subwards awarded under the Metropolitan Transportation Planning Program. In addition, 23 of the 24 samples tested for the Transit Services Cluster were not submitted timely, with 17 not being reported at all. Failure to implement a process over FFATA reporting results in late or non-submission of subaward information and noncompliance with the grant agreement.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Caltrans should implement policies and procedures to report subaward information under FFATA for the Metropolitan Transportation Planning program and the Transit Services Cluster.

## Department's View and Corrective Action Plan

Caltrans Office of Regional Planning (ORP) Fund Specialists will create an account with the Federal Subaward Reporting System (FSRS) and report information for subawards of \$25,000 or more awarded through the Metropolitan Transportation Planning Program. ORP Fund Specialists will update this information at the beginning of the state fiscal year 2015/2016 and on an ongoing basis through periodic visits to the FSRS.

## Contact

Erin Thompson, Regional Planning Branch Chief

## Implementation Date

July 1, 2015

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Reference Number:	2014-020
Federal Catalog Number:	20.505
Federal Program Title:	Metropolitan Transportation Planning
Federal Award Number and Year:	CA-81-0011-00; 2014 CA-81-0010-00; 2013

Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

## 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;
- (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

Caltrans does not have adequate controls over award communication to subrecipients. Caltrans did not properly communicate the Catalog of Federal Domestic Assistance (CFDA) title and number for all 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. Caltrans passed through \$63.1 million to Metropolitan Transportation Planning subrecipients during fiscal year 2013-14.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Caltrans should improve its award communication process to subrecipients to ensure that it includes the CFDA title and number in all subawards.

## Department's View and Corrective Action Plan

Effective July 1, 2015, ORP will include the CFDA title and number on the encumbrance document for all Metropolitan Planning Organizations and Regional Transportation Planning Agencies that receive Metropolitan Planning funds

**Contact**

Erin Thompson, Regional Planning Branch Chief

**Implementation Date**

July 1, 2015

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Reference Number:	2014-021
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)
Federal Catalog Number:	20.513, 20.516, 20.521
Federal Program Title:	Transit Services Cluster
Federal Award Number and Year:	CA-16-0057-00; 2012 CA-37-X166-00; 2012 CA-57-X085-00; 2012 CA-16-0055-00; 2010 CA-37-X128-00; 2010 CA-37-X131-00; 2010 CA-57-X053-00; 2010

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Federal Catalog Number:	20.509
Federal Program Title:	Formula Grants for Rural Areas
Federal Award Number and Year:	CA-18-X059-00; 2013 CA-18-X052-00; 2012 CA-85-X004-00; 2011 CA-18-X043-00; 2010 CA-86-X001-00; 2009 CA-18-X025-00; 2007

**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

During our fiscal year 2012-13 audit, we reported that Caltrans did not have adequate controls in place to evidence its review of SF-425 reports and could not provide support for certain key line items within the SF-425 for the Formula Grants for Rural Areas program. In fiscal year 2013-14, Caltrans did not provide evidence of review of the SF-425 for both the Formula Grants for Rural Areas Program and the Transit Services Cluster. In addition, for three of four reports tested for the Formula Grants for Rural Areas Program and all four reports tested for the Transit Services Cluster, support for the Recipient Share of Expenditures, Federal Share of Unliquidated Obligations, and Recipient Share of Unliquidated Obligations line items could not be provided. Failure to retain supporting documentation for amounts reported and lack of adequate review controls 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 review process over the SF-425 reports to evidence its review by someone other than the preparer, and maintain the support for amounts reported.

## Department's View and Corrective Action Plan

Caltrans implemented procedures to retain supporting documentation and evidence of supervisory approvals in response to the previous year's audit report. However, the issues identified in the current year audit occurred prior to implementation in February 2014 of the improved procedures. Caltrans will continue current procedures to retain supporting documentation and evidence of supervisory approvals.

## Contact

Rico Pobre, Division of Accounting

## Implementation Date

February 2014

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Reference Number:	2014-022
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)
Federal Catalog Number:	20.509
Federal Program Title:	Formula Grants for Rural Areas
Federal Award Number and Year:	CA-18-X059-00; 2013 CA-18-X052-00; 2012 CA-85-X004-00; 2011 CA-18-X043-00; 2010 CA-86-X001-00; 2009 CA-18-X025-00; 2007

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Federal Catalog Number:	20.513, 20.516, 20.521
Federal Program Title:	Transit Services Cluster
Federal Award Number and Year:	CA-16-0057-00; 2012 CA-37-X166-00; 2012 CA-57-X085-00; 2012 CA-16-0055-00; 2010 CA-37-X128-00; 2010 CA-37-X131-00; 2010 CA-57-X053-00; 2010

## 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

During our audit for fiscal year 2012-13, we reported that 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 for the Formula Grants program. In fiscal year 2013-14, Caltrans passed Formula Grants funding to 90 subrecipients, including 24 cities, 15 counties, one town, and 50 special districts, and had not yet implemented its corrective action plan from the fiscal year 2012-13 audit. For the Transit Services Cluster, Caltrans passed funding to 61 subrecipients, including nine cities, two counties, and 50 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. For the Formula Grants program, we identified eight 2013 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 2013-14, Caltrans passed \$15.2 million through to subrecipients that expended less than \$500,000 in Formula Grants funds. For the Transit Services Cluster, we identified 26 special district OMB Circular A-133 reports for 2013 that were not reviewed by Caltrans because they expended less than \$500,000 in federal awards received from Caltrans. In fiscal year 2013-14, Caltrans passed \$4.1 million through to subrecipients that expended less than \$500,000 in Transit Services Cluster funds.

Since Caltrans did not review these reports, it cannot determine if the Formula Grants program or Transit Services Cluster were audited and whether or not findings were issued that required a management decision from Caltrans. Failure to obtain and review single audit reports of all 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 implement its process to obtain and review single audit reports of all subrecipients who expend more than \$500,000 in federal awards and issue management decisions, as necessary. Caltrans should verify that all subrecipients who did not submit single audit reports incurred less than \$500,000 in federal expenditures.

## Department's View and Corrective Action Plan

All special districts for which Caltrans knew federal funds were passed through in fiscal year 2012-13 were followed up with and either a single audit report or an exemption was received. Some of this follow-up occurred after KPMG's cut-off of June 30, 2014, but we are not aware of any deadline by which to follow up with subrecipient entities. There were some special districts included in KPMG's testing, however, that Caltrans was not aware had received federal pass-through funds. Caltrans will follow up with these entities to ensure they have either submitted a single audit report or are exempt. Caltrans administering programs will work with the Division of Accounting to ensure we have a complete list of subrecipients moving forward.

Subsequent to the audit period reviewed by KPMG, Caltrans administering programs met on procedures to ensure they follow up with all entities to which they pass through federal funds, regardless of Caltrans' expenditures, to ensure the entities either receive a single audit report or certification the entity is exempt. Caltrans shared the procedures with KPMG and received their input.

## Contact

MarSue Morrill, Audits and Investigations

## Implementation Date

Beginning fiscal year 2014-15

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Reference Number:	2014-023
Federal Catalog Number:	20.513, 20.516, 20.521
Federal Program Title:	Transit Services Cluster
Federal Award Number and Year:	CA-16-0057-00; 2012 CA-37-X166-00; 2012 CA-57-X085-00; 2012 CA-16-0055-00; 2010 CA-37-X128-00; 2010 CA-37-X131-00; 2010 CA-57-X053-00; 2010
Category of Finding:	Equipment and Real Property Management
Type of Finding:	Material Weakness and Material Instance of Noncompliance



State Administering Department: California Department of Transportation  
(Caltrans)

## Criteria

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: Property Standards, 215.34 - Equipment.

- (f) The recipient's property management standards for equipment acquired with Federal funds and federally owned equipment shall include all of the following:
  - (3) A physical inventory of equipment shall be taken and the results reconciled with the equipment records

## Condition

Caltrans does not have controls in place to ensure that all equipment is inspected within the required time frame for the Transit Services Cluster. Caltrans did not inspect 106 of the 849 pieces of equipment that were required to be inspected within the last three years. In addition, of 65 equipment inspections tested, Caltrans was unable to provide supporting inspection reports and monitoring letters for eight inspections. Failure to perform equipment inspections increases the risk that subrecipients are not utilizing equipment in accordance with federal requirements.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Caltrans should strengthen its procedures around equipment inspections to ensure all equipment is inspected every three years and that the reports and monitoring letters are maintained.

## Department's View and Corrective Action Plan

Physical Inspections - The Division of Rail and Mass Transportation works diligently to comply with all federal requirements documented in our State Management Plan (SMP) and approved by the Federal Transit Administration (FTA). As identified in this finding, not all equipment was inspected as the division worked through an unprecedented State fiscal crisis and a subsequent staffing reduction of almost 50%. During the three-year period reviewed, the Division performed monitoring inspections to the maximum extent possible, but did not achieve all needed inspections. The Division is committed to following the SMP and is working to perform all needed inspections at a rate of 1/3, 1/3 and 1/3 per year, so that all inspections are completed in a three-year cycle.

Inspection Reports - The inspection records not found during the audit were due to a one-time filing mistake. The original inspection reports were mailed to local agencies without copies being kept and maintained in the Caltrans project history folders

## Contact

Bruce Plowman Chief, Section 5310 Program

**Implementation Date**

January 2015

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Reference Number:	2014-024
Federal Catalog Number:	20.513, 20.516, 20.521
Federal Program Title:	Transit Services Cluster
Federal Award Number and Year:	CA-16-0057-00; 2012 CA-37-X166-00; 2012 CA-57-X085-00; 2012 CA-16-0055-00; 2010 CA-37-X128-00; 2010 CA-37-X131-00; 2010 CA-57-X053-00; 2010
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

**Criteria**

TITLE 2 – GRANTS AND AGREEMENTS, PART 25 – UNIVERSAL IDENTIFIER AND CENTRAL CONTRACTOR REGISTRATION, Appendix A to Part 25 – Award Term

I. Central Contractor Registration and Universal Identifier Requirements

B. Requirement for Data Universal Numbering System (DUNS) Numbers

If you are authorized to make subawards under this award, you:

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**

Caltrans did not have proper controls in place to obtain DUNS numbers prior to making subawards under the Transit Services Cluster. We noted for 23 of the 24 subgrants tested, subawards were made prior to obtaining a DUNS number for the subrecipient. Failure to obtain the DUNS numbers prior to awarding funds increases the risk that subawards may be incorrectly reported.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Caltrans should develop policies and procedures to obtain DUNS numbers prior to awarding federal funds for the Transit Services Cluster.

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

To comply with the DUNS number requirements stated in #1 and # 2 above, we changed our DUNS number collection process. In our call for Projects that was issued 10/1/2014, we added a field on our grant applications for subrecipient agencies to enter their DUNS number. Without the DUNS number the application will be considered incomplete and will not be approved. These changes are already in effect.

**Contact**

Bruce Plowman Chief, Section 5310 Program

**Implementation Date**

January 1, 2015

## U.S. DEPARTMENT OF EDUCATION

Reference Number:	2014-025
Federal Catalog Number:	84.027
Federal Program Title:	Special Education Cluster (IDEA)
Federal Award Number and Years:	H027A130122; 2013 H173A130120; 2013 Hf027A120116; 2012 H173A120120; 2012 H027A110116; 2011 H173A110120; 2011
Category of Finding:	Level of Effort – Maintenance of Effort
Type of Finding:	Instance of Noncompliance
State Administering Department:	California Department of Education (Education)

### Criteria

TITLE 20 – EDUCATION, CHAPTER 33 – EDUCATION OF INDIVIDUALS WITH DISABILITIES, SUBCHAPTER II – ASSISTANCE FOR EDUCATION OF ALL CHILDREN WITH DISABILITIES, Section 1412 – State Eligibility

- (a) In general – A State is eligible for assistance under this subchapter for a fiscal year if the State submits a plan that provides assurances to the Secretary that the State has in effect policies and procedures to ensure that the State meets each of the following conditions:

(18) Maintenance of State financial support

- (A) In general – The State does not reduce the amount of State financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year.

(B) Reduction of funds for failure to maintain support

The Secretary shall reduce the allocation of funds under section 1411 of this title for any fiscal year following the fiscal year in which the State fails to comply with the requirement of subparagraph (A) by the same amount by which the State fails to meet the requirement.

(C) Waivers for exceptional or uncontrollable circumstances

The Secretary may waive the requirement of subparagraph (A) for a State, for 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 audits for fiscal years 2011-12 and 2012-13, we reported that Education did not meet its maintenance of effort (MOE) requirements and did not obtain a waiver from the U.S. Department of Education. In fiscal year 2013-14, Education again did not meet its MOE requirement by \$19,172,953, nor did it request a waiver. Failure to meet MOE requirements increases the risk of reduced federal funding.

## **Questioned Costs**

No specific questioned costs were identified.

## **Recommendations**

Education should monitor compliance throughout the grant period to ensure MOE requirements are 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 appropriates special education expenditures on the basis of the AB 602 funding formula. The AB 602 funding formula requires Education to make multiple calculations/appropriations of state special education funds over a two year period. Thus, the fiscal year 2013-14 AB 602 final principal apportionment will not be calculated and made available until July 2016. As part of California's Annual State Application for 2015, Section V – Maintenance of State Financial Support (SMFS), Education provides the U.S. Department of Education, Office of Special Education Programs (OSEP), preliminary maintenance of state financial support for fiscal year 2012-13 and fiscal year 2013-14 which is based upon the most current certified special education appropriation amounts. In prior year applications, the CDE has informed OSEP that the SMFS is preliminary; this approach has been acceptable to OSEP in previous years.

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. If the expenditure data demonstrates that state financial support did not meet MOE requirements, Education will request the necessary funding from the Legislature. In prior years, the Legislature has responded to our identification of final MOE shortfalls in the past by appropriating additional funding to offset the shortage of funds; however, there have also been years where the final data reflected no shortfall.

The Legislature controls the appropriations that provide financial support for services to students with disabilities across state agencies. Education exercises control over the distribution and expenditures of the allocations received, but has no control over the financial support appropriated by the Legislature and approved by the Governor. If the Legislature does not provide Education with sufficient funding to meet MOE requirements, Education will seek a remedy, such as a waiver, from the federal Office of Special Education Program.

## **Contact**

Fred Balcom, Director, Special Education Division

## **Implementation Date**

July/August 2015

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Reference Number:	2014-026
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)
Federal Catalog Number:	84.282
Federal Program Title:	Charter Schools
Federal Award Number and Year:	U282A100013-13; 2014 U282A100013-12; 2013 U282A100013-11; 2012 U282A100013-11B; 2012 U282A100013; 2011 U282A100013A; 2011

## 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.

## Condition

In fiscal year 2013-14, Education did not have a process in place to obtain DUNS numbers from its Charter Schools Program subrecipients, and therefore, did not obtain DUNS numbers prior to awarding federal funds. Failure to obtain DUNS numbers increases the risk that subawards may be incorrectly reported.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Education should implement policies and procedures to obtain DUNS numbers from Charter Schools Program subrecipients prior to approving the subaward.

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

Education accepts the recommendation. Beginning with the Fiscal Year 2014-15 Public Charter Schools Grant Program Request for Applications (Revised February 2015), Education has implemented changes to the policies and procedures for obtaining DUNS numbers prior to approving subawards. Education added a requirement to the sub-recipient application process which now requires the DUNS numbers be provided.

**Contact**

Cindy S. Chan, Interim Director, Charter Schools Division

**Implementation Date**

February 2015

## U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

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Reference Number:	2014-027
Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program (CHIP)
Federal Award Number and Years:	05-14A5CA5021; 2014 05-13A5CA5021; 2013 05-12A5CA5021; 2012
Category of Finding:	Allowable Activities Foster Care Title IV-E
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Health Care Services (Health Care Services)

### 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 7974 – *Year-End Report No. 13, Report of Expenditures of Federal Funds* states that at year-end, departments will prepare a Report of Expenditures of Federal Funds, Report No. 13, for all federal funds.

The original signed Report No. 13 is to be submitted to the Department of Finance (Finance), Fiscal Systems and Consulting Unit by August 20th. A copy of Report No. 13 must be submitted to the State Controller's Office with the year-end financial reports. Supporting documentation used to prepare the Report No. 13 must be maintained by the department in the event Finance, Office of State Audits and Evaluations, or the California State Auditor's Office requests to review.

### Condition

Health Care Services does not have a process in place to reconcile CHIP fee-for-service claims to its general ledger system. Fee-for-service claims detail is maintained within the California Medicaid Management System (CA-MMIS) and is recorded by Health Care Services into its general ledger system through a weekly check-write. Upon our request, Health Care Services reconciled the fee-for-service claims to amounts reported in the general ledger; however, Health Care Services did not identify claims that had a split funding source resulting from the enactment of the Affordable Care Act so it took 10 months to reconcile these amounts. Failure to reconcile fee-for-service claims detail to the general ledger may result in errors on the state's Report No. 13 and in reporting to the federal government.

### Questioned Costs

No specific questioned costs were identified.



## Recommendations

Health Care Services should implement a reconciliation process over fee-for-service claims detail from CA-MMIS to amounts reported in the general ledger.

## Department's View and Corrective Action Plan

Health Care Services does not agree with the finding that there is no process to reconcile fee-for-service claims. On a weekly basis there are multiple systematic checks and balancing that occur to ensure that the checkwrite amounts match the amounts funded within the CMS64 accounting system. The dollars are balanced prior to transmission to the Accounting System, and a further check/balance occurs within the CMS64 system.

Health Care Services acknowledges that two system issues were identified that affected the value in the funding field on CA-MMIS history for Affordable Care Act (ACA) claims. These claims funded correctly during the weekly checkwrite process. However, when claims were pulled from history for the audit request, a small subset of claims did not contain an identifier that indicated that the claims had split funding sources. Therefore, the entire amount of the claim was included in the calculation; where only a portion of the claim was funded MCHIP.

Health Care Services has opened projects to correct the system for the two issues identified. These efforts are referenced in Problem Statement CMMIS26407, initiated on December 17, 2014 and FI Letter A-4617, dated February 13, 2015.

## Contact

Bill Otterbeck, Assistant Deputy Director, CAMMIS

## Implementation Date

Not applicable

## Auditors' Conclusion

We acknowledge that Health Care Services has a process to reconcile checkwrite amounts to the CMS64 system; however, Health Care Services does not have a process to reconcile fee-for-service individual transactions to the checkwrite or general ledger. As a result, Health Care Services was not able to provide detail necessary for audit purposes without significant effort towards the reconciliation. As a result, we concluded that the controls are not operating effectively to reconcile detailed claimant data to the general ledger.

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Reference Number:	2014-028
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)
Federal Catalog Number:	93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1405CA5MAP; 2014 05-1405CA5ADM; 2014 05-1305CA5MAP; 2013 05-1305CA5ADM; 2013

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Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program (CHIP)
Federal Award Number and Year:	05-14A5CA5021; 2014 05-13A5CA5021; 2013 05-12A5CA5021; 2012

## 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 non-MAGI 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.

OMB Circular A-133, Compliance Supplement was revised to also provide guidance over Medicaid Eligibility.

## E. Eligibility

## 1. Eligibility for Individuals

The auditor should not test eligibility for determinations based on Modified Adjusted Gross Income (MAGI-based determination) made after September 30, 2013. Detailed testing is performed under the Medicaid and CHIP Eligibility review Pilots, which serve as CMS' oversight of Medicaid and CHIP eligibility determinations during the initial years of Affordable Care Act implementation. Since the Medicaid and CHIP Eligibility Review Pilots do not review non-MAGI based cases (i.e. Aged, Blind, and Disabled), the auditor should test non-MAGI determinations.

### 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 expanded Medicaid coverage and simplified 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 (MAGI) and citizenship, immigration status, incarceration status and other healthcare 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.

During fiscal year 2013–14, Health Care Services reassessed the need to ensure relevant eligibility control and compliance objectives were subject to audit at the county. Health Care Services estimates there are approximately 1 million Medi-Cal beneficiaries whose determinations were made by the counties using the SAWS. Health Care Services also concluded that given anticipated changes in federally mandated Medi-Cal eligibility quality control reviews to include non-MAGI determinations,

ensuring eligibility was audited at the county was not necessary. Given that non-MAGI beneficiaries make up approximately 9 percent of the 10.9 million Medi-Cal beneficiaries and counties perform all parts of non-MAGI eligibility determinations, the county auditor is responsible for meeting internal control and compliance objectives for non-MAGI 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 Services (CMS) and counties, to ensure relevant eligibility control and compliance objectives are subject to audit at the county or obtain written approval from CMS that non-MAGI eligibility should not be in the scope of county OMB Circular A-133 audits and instead be tested by the state auditor.

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

Health Care Services agrees that the SAWS are owned, operated and maintained by the respective 58 counties throughout the state. However, Health Care Services contends that existing federally mandated Medi-Cal eligibility quality control reviews performed by Health Care Services, along with additional reviews that Health Care Services is planning to implement in fiscal year 2015-16, is more than sufficient to meet county internal control and compliance objectives for eligibility. The fact that Health Care Services is performing the reviews instead of county auditors should not preclude the objectives from being met. Health Care Services is currently working closely with the 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 Health Care Services staff re-performing eligibility determinations from a random sample that will identify potential errors made by SAWS and/or county eligibility workers, including non-MAGI determinations starting in Round 3 (10/1/14 – 3/31/15) of the quality control pilots. In addition, pursuant to Senate Bill 28 (Hernandez, Chapter 4, Statutes of 2013), Health Care Services is required to implement a new budgeting methodology for county administrative costs that Health Care Services plans to implement no sooner than FY 2015/16. The new budgeting methodology is intended to address the changes in eligibility determination rules and processes resulting from implementation of ACA. A core element of the new budgeting methodology is to utilize 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 contractor will be used as part of the new budgeting methodology. Health Care Services suggests the auditor of the State continue to audit Medi-Cal eligibility performed by the SAWS/counties for fiscal year 2014-15 and close out this audit finding based on implementation of the Health Care Services review processes described above.

### **Contact**

Robert Sugawara, Chief, Program Review Branch, Medi-Cal Eligibility Division

### **Implementation Date**

Not applicable

### **Auditors' Conclusion**

Health Care Services should obtain approval of their corrective action plan in writing from CMS.

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Reference Number:	2014-029
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)
Federal Catalog Number:	93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1405CA5MAP; 2014 05-1405CA5ADM; 2014 05-1305CA5MAP; 2013 05-1305CA5ADM; 2013

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Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program (CHIP)
Federal Award Number and Year:	05-14A5CA5021; 2014 05-13A5CA5021; 2013 05-12A5CA5021; 2012

## Criteria

### TITLE 42 – PUBLIC HEALTH, PART 431 – STATE ORGANIZATION AND GENERAL ADMINISTRATION

#### – Sec. 431 – Single State Agency

#### (c) Determination of eligibility.

- (1) The plan must specify whether the agency that determines eligibility for families and for individuals under 21 is—
  - (i) The Medicaid agency; or
  - (ii) The single State agency for the financial assistance program under title IV-A (in the 50 States or the District of Columbia), or under title I or XVI (AABD), in Guam, Puerto Rico, or the Virgin Islands.
- (2) The plan must specify whether the agency that determines eligibility for the aged, blind, or disabled is—
  - (i) The Medicaid agency;
  - (ii) The single State agency for the financial assistance program under title IV-A (in the 50 States or the District of Columbia) or under title I or XVI (AABD), in Guam, Puerto Rico, or the Virgin Islands; or

- (iii) The Federal agency administering the supplemental security income program under title XVI (SSI). In this case, the plan must also specify whether the Medicaid agency or the title IV-A agency determines eligibility for any groups whose eligibility is not determined by the Federal agency
- (3) The plan must specify whether the entity that determines eligibility is an Exchange established under sections 1311(b)(1) or 1321(c)(1) of the Affordable Care Act (Pub. L. 111-148), provided that if the Exchange is operated as a nongovernmental entity as permitted under 45 CFR 155.110(c), or contracts with a private entity for eligibility services, as permitted under 1311(f) (3) of the Affordable Care Act and 45 CFR 155.110(a), final determinations of eligibility are limited to determinations using MAGI-based methods as set forth in § 435.603 of this subchapter.
- (4) The single State agency is responsible for ensuring eligibility determinations are made consistent with its policies, and if there is a pattern of incorrect, inconsistent, or delayed determinations for ensuring that corrective actions are promptly instituted.

#### 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

Health Care Services did not have a process in place throughout fiscal year 2013–14 to monitor counties to ensure that non-MAGI eligibility determinations are made in accordance with state and federal regulations. Health Care Services estimates there are approximately 1 million Medi-Cal beneficiaries whose eligibility determinations were made by the counties using the county-owned state Automated Welfare Systems (SAWS). Failure to monitor eligibility increases the risk that payments may be made to providers for ineligible beneficiaries.

In a letter dated August 15, 2013, the Centers for Medicare & Medicaid Services (CMS) notified California that due to the implementation of the Patient Protection and Affordable Care Act of 2010, Payment Error Rate Measurement (PERM) and the Medicaid Eligibility Quality Control (MEQC) programs would be replaced by an annual 50-state pilot program beginning January 1, 2014. Based on this guidance, Health Care Services eliminated all monitoring programs in October 2013, including those for non-MAGI eligibility determinations.

#### Questioned Costs

No specific questioned costs were identified.



## Recommendations

Health Care Services should implement policies and procedures to monitor county non-MAGI determinations.

## Department's View and Corrective Action Plan

Health Care Services disagrees with the recommendation. In response to the implementation of ACA, CMS issued a directive on August 15, 2013, that instructed states to suspend MEQC and PERM reviews effective December 31, 2013. This directive mandated states to participate in a series of four separate pilot review programs, the first of which commenced in January 2014. To date, Health Care Services has completed two of the four required pilot programs; however, prior to the suspension of MEQC and PERM reviews, Health Care Services quality control staff continued to perform reviews of Non-MAGI determinations through December 31, 2013; therefore, Health Care Services did have review processes in place to monitor Non-MAGI determinations for part of FY 2013/14. In addition, KPMG performed audits on Non-MAGI determinations for FY 2013/14 and KPMG did not identify any errors in the eligibility determinations reviewed. Based on these findings, DHCS believes that sufficient processes were in place to monitor Non-MAGI determinations for the FY 2013/14.

Under the initial two pilot programs, CMS did not mandate states conduct quality control reviews of Non-MAGI determinations. In January 2015, CMS issued guidance for the third pilot program, which required states to resume reviews of this population. Consequently, beginning April 2015, Health Care Services will commence quality control reviews of non-MAGI determinations. Since CMS requires Health Care Services to perform quality control reviews of non-MAGI determinations, Health Care Services contends that additional internal processes for monitoring Non-MAGI determinations are not needed.

## Contact

Rocky Evans, Acting Chief, Program Review Branch

## Implementation Date

April 2015

## Auditors' Conclusion

OMB Circular A-133 requires Health Care Services to "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." The recommendation does not comment on procedures in addition to those required by CMS, only that policies and procedures to monitor non-MAGI determinations done by counties be put into place. Health Care Services only reviewed non-MAGI determinations made through September 2014 (these reviews were completed in December 2014); therefore, nine months of non-MAGI determinations were not reviewed. In addition, as noted in finding no. 2014-028, Health Care Services did not inform county auditors that non-MAGI eligibility was the responsibility of the county auditor.

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Reference Number:	2014-030
Category of Finding:	Allowable Activities/Allowable Costs
Type of Finding:	Material Weakness
State Administering Department:	Department of Health Care Services (Health Care Services)
Federal Catalog Number:	93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster

Federal Award Number and Year: 05-1405CA5MAP; 2014  
05-1405CA5ADM; 2014  
05-1305CA5MAP; 2013  
05-1305CA5ADM; 2013

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Federal Catalog Number: 93.767  
Federal Program Title: Children's Health Insurance Program  
Federal Award Number and Year: 05-14A5CA5021; 2014  
05-13A5CA5021; 2013  
05-12A5CA5021; 2012

## 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.

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 2012-13 audit, we reported that certain information security controls over the California Medicaid Management System (CA-MMIS) were not operating effectively. Health Care Services utilizes a third-party fiscal intermediary to adjudicate fee-for-service (FFS) claims.

In the 2013-14 audit, we found that certain information security and change management controls over CA-MMIS were also not operating effectively. The failure of these controls was due to the lack of adequate implementation of CA-MMIS policies and procedures. Ineffective IT general controls over the information technology environment, including access and change management, could result in inappropriate claims being processed.

Specifically, we identified the following:



- CA-MMIS policy requires users to log onto the mainframe every 29 days. We identified 174 accounts that have been idle for more than 29 days. This includes 16 accounts that appear to have never been accessed and 42 accounts that have not been accessed in over 98 days. Of the 174 accounts identified two are test accounts, 14 are Help Desk accounts and the remainder are user accounts.
- We identified 84 User ID (UID) strings that are not defined on the Xerox role sheet. As a result, we were unable to identify the associated roles and privileges associated with these accounts to validate the appropriateness of the user privileges. These UID strings belong to 500 Access Control Facility (ACF2) accounts.
- Health Care Services was unable to produce a complete listing of employees. We found 1,303 CA-MMIS user accounts that could not be found on the HR listings provided. Given the large volume of user accounts, maintaining a complete listing of employees and comparing that listing to user accounts would provide a reliable way to identify terminated employees and validate user access and privilege levels.
- We selected five standard changes promoted into the production environment for testing and identified one change with an invalid test result for one test script performed and one change with invalid test results for all test scripts performed. Both changes identified were marked "Passed" and promoted into the production environment despite not passing the required test scripts.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Health Care Services should work with the FI to ensure IT general controls are operating effectively. Specifically, Health Care Services should:

1. Ensure accounts that have been idle for more than 29 days are disabled.
2. Identify and document the associated roles and privileges for all UID strings.
3. Maintain a complete employee listing that can be used to identify terminated employees.
4. Ensure program changes are thoroughly reviewed and all test scripts are valid prior to promotion into the production environment.

## Department's View and Corrective Action Plan

Health Care Services agrees with the Audit Finding.

The fiscal year 2013-14 CA-MMIS audit material weakness findings are known to Health Care Services. The Contract requires annual reviews and/or updates for all CA-MMIS documentation listed in the Contract, Exhibit A, Attachment II, Sections HH-QQ including but not limited to Manuals, Deliverables, Plans, Policies, and Procedures. Several CA-MMIS Policies, Procedures, Plans, and other documentation are missing, inadequate, or have not been updated since fiscal year 2010-11.

Timely and accurate documentation is essential to maintain security and confidentiality of the CA-MMIS systems. Evidence that documentation creation, reviews and updates are not taking place, or lack of adequate procedures to ensure required documentation is created, reviewed and updated, at least annually, are of the greatest concern to Health Care Services. CA-MMIS issued two Corrective Action Plan (CAP) requests to Xerox within the last 12 months to address these findings and concerns.

CAP 022 addressed user access and other system security deficiencies. Xerox responded with a request for closure, referencing existing plans that addressed Health Care Services concerns. On March 2nd, 2015, DHCS formally denied Xerox's request to close CAP 022, Ref. A4672. The denial basis highlighted non-existent process or procedure level documentation necessary to address gaps where Xerox does not follow security policies. The current audit findings further support previous CA-MMIS analyses and decision to ultimately deny Xerox's CAP closure request.

CA-MMIS sent another CAP Request on February 24th, 2015, to address deficient documentation, Ref. A-4604. This CAP intended to update documentation failing to meet contract compliance standards. The CAP must define methods by which improvements will be attained, the specific timeline and milestones, and assigned resources for achieving satisfactory and sustained performance including a specific and measurable criterion to be utilized in determining satisfactory and sustained performance. CA-MMIS requires this documentation to be formally submitted to Health Care Services. However, Xerox failed to prepare and submit a CAP response to this issue by 2:00p.m. on March 5, 2015. CA-MMIS will follow up with a delinquency letter by March 13th, 2015.

Currently, no sanctions are actively exercised against Xerox. CA-MMIS will reaffirm the need for a formal extension of time when Xerox cannot meet Health Care Services' deadlines. From an accountability perspective, if Xerox was egregiously non-responsive, the Department could in its discretion withhold the General Adjudicated Claim Line invoice as a consequence for non-compliance of the Corrective Action Plan.

CA-MMIS is confident that these two CAPs address the 2013-14 audit findings as well as other deficiencies. However, each CAP scope is highly complex and addresses both mainframe and other CA-MMIS enterprise systems, 90+ subsystems in all. While it is possible to prioritize correction of the 2013-14 audit findings early in the resolution plan, the scale and effort to address the entire CAP is considerably large. For this reason, CA-MMIS chooses to initiate a separate third CAP request to specifically address the current findings. With a minimized scope, the third CAP achieves a more timely resolution of these specific findings:

- Enforcement of the mainframe account policy to deactivate user IDs that have been idle for 29 days.
- Complete documentation of the 84 User ID (UID) strings not currently defined on Xerox's role based security sheet.
- Develop process and procedures to regularly compare current employee listings, from all CA-MMIS business partners, to the mainframe account user database.
- Update change control documentation to include checklist approval criteria associated with test script review and validation.

CA-MMIS plans to immediately initiate this third CAP request to Xerox and will issue the CAP no later than March 13, 2015.

## Contact

Dr. Jazz Kaur, CA-MMIS Audit Coordinator

## Implementation Date

June 30, 2015

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Reference Number:	2014-031
Federal Catalog Number:	93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1405CA5MAP; 2014 05-1405CA5ADM; 2014 05-1305CA5MAP; 2013 05-1305CA5ADM; 2013
Category of Finding:	Activities Allowed/ Allowable Costs
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

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Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program
Federal Award Number and Year:	05-14A5CA5021; 2014 05-13A5CA5021; 2013 05-12A5CA5021; 2012

## Criteria

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

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

OMB CIRCULAR A-133 COMPLIANCE SUPPLEMENT – Part 4 Agency Program Requirements, Medicaid Cluster

Managed care providers must be eligible to participate in the program at the time services are rendered, payments to managed care plans should only be for eligible clients for the proper period, and the capitation payment should be properly calculated.

## Condition

Health Care Services has not properly configured the capitation file extracted from the Medicaid Eligibility Database System (MEDS) used to calculate capitation payments to health plans. The extraction contains a 13-month aid code history and is designed by MEDS to retrieve capitated historical information as of a point in time. Since the extraction is as of a point in time, it would not reflect a retroactive change in aid code and status posted in a previous month. As a result, changes in aid codes that affect capitation payments are correctly recorded in the month subsequent to the change being posted; however, Health Care Services does not adjust previous months for changes that should be retroactive. Total federal Medicaid expenditures made by Health Care Services for capitation

payments to health plans amounted to \$10.8 billion for the fiscal year 2013–14. Health Care Services could not determine the amount of questioned costs, if any, resulting from this error in configuration without significant cost and effort.

### Questioned Costs

Questioned costs could not be determined.

### Recommendations

Health Care Services should reevaluate the capitation file extracted from MEDS to ensure retroactive changes in aid codes are properly adjusted in subsequent capitation payments. Additionally, Health Care Services should work with the Centers for Medicare and Medicaid Services to determine whether or not it should quantify any questioned costs in prior years resulting from this erroneous configuration.

### Department's View and Corrective Action Plan

Health Care Services agrees with the recommendation. Health Care Services will begin work to be completed by the end of June 30, 2015. This will require IT resources to evaluate the ability to enhance the aid code methodology that extracts the aid code from MEDS. The intent of the effort will be to ensure the payment system is receiving the accurate date for payment in regards to the aid code for the current month and the retroactive periods.

Health Care Services will assess any negative impact to determine whether or not any cost negatively impacted the program. This assessment will be done by September 30, 2015.

### Contact

Javier Portela, Acting Chief Managed Care Project Management Operations Division

### Implementation Date

September 2015

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Reference Number:	2014-032
Federal Catalog Number:	93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1405CA5MAP; 2014 05-1405CA5ADM; 2014 05-1305CA5MAP; 2013 05-1305CA5ADM; 2013
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) 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 audits for fiscal years 2011–12 and 2012–13, 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 2013–14, 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 certain eligibility determinations 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 \$1.9 billion to subrecipients for county and school-based administrative activities in fiscal year 2013–14.

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 and 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 they are unable to travel which are equivalent in scope to a site visit. However, we identified 15 of the 28 local government agencies or local education consortiums that are part of the school-based program 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. The Department agrees with the finding and is working with our contractors to finalize a process to obtain DUNS numbers from contractors and sub-recipients. A Policy and Procedure Letter (PPL) will be issued to all contractors advising of the requirement.
2. The Department agrees with the finding and is currently reviewing site visit requirements to include new implementation plans and is expected to begin site visits spring 2015.
3. In conjunction with Item #1 - the Department agrees with the finding and is finalizing a process to collect the expenditures of federal funds passed through to sub-recipients. This new process will be disseminated in the PPL issued in Item #1.

## Contact

Michelle Kristoff, Chief Administrative Claiming Local and School Services Branch, Safety Net Financing Division

## Implementation Date

March 2015

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Reference Number:	2014-033
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; 2015 X09HA26794; 2015 X07HA12778; 2014 X08HA19011; 2014 X09HA20246; 2014 X09HA19011; 2013 X09HA20246; 2013 X09HA24703; 2013
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, 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

During our fiscal year 2012-13 audit, we reported that Public Health did 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. Public Health is in the process of notifying subrecipients of the CFDA title and number, but again did not communicate this information during fiscal year 2013-14. Failure to properly communicate award information increases the risk that subrecipients may inappropriately spend federal funds or fail to comply with federal regulations, including OMB Circular A-133 audit requirements. Public Health passed through \$23.8 million to subrecipients during fiscal year 2013-14.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Public Health should implement policies and procedures to communicate the CFDA title and number to subrecipients when it issues subawards.

## Department's View and Corrective Action Plan

Public Health agrees with the recommendation for State Fiscal Year 2013-14 and will immediately implement policies and procedures to communicate the CFDA title and number to subrecipients. Public Health will immediately communicate the CFDA number and title via email and Management Memo issued to subrecipients and is processing amended contracts with an effective date of April 1, 2015, which is in State Fiscal Year 2014-15. Public Health will display the CFDA title and number on the amended contract scopes of work and have notified OA contract processing staff that inclusion of the CFDA number and title is standard practice.

Public Health is amending contracts with an effective date of April 1, 2015 and thereafter to display the CFDA number and title in the scope of work.

Public Health did fail to implement part of its corrective action plan. The steps taken by Public Health were:

1. CDPH did not immediately communicate CFDA number and title through informal written communication, but is doing so now;
2. immediately revised Public Health contract policies and procedures to include the CFDA number and title in the scope of work; and,
3. developed a formal implementation plan that was initiated through Management Memos and review of Contracts Management Unit subject memo and contract amendments.

Public Health was unable to change existing contracts in place during State Fiscal Year 2013-14 due to time needed to amend contracts. However, Public Health took the above steps to implement the corrective action plan that resulted in contract amendments for State Fiscal Year 2014-15, which have an effective start date of April 1, 2015.



## Contact

Schenelle Flores, HIV Administration Branch Chief, Office of AIDS, Center for Infectious Diseases, California Department of Public Health

## Implementation Date

Implementation date is in State Fiscal Year 2014-15 and no earlier than April 1, 2015. The contracts effective date for FY 2014-15 starts April 1, 2015.

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Reference Number:	2014-034
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)
Federal Catalog Number:	93.958
Federal Program Title:	Block Grants for Community Mental Health Services
Federal Award Number and Year:	2B09SM010005-14; 2014 3B09SM010005-13; 2013 2B09SM010005-13; 2013 2B09SM010005-12; 2012

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Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse
Federal Award Number and Year:	3B08TI010062-14; 2014 3B08TI010062-13; 2013 3B08TI010005-12; 2012

## Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 25 – UNIVERSAL IDENTIFIER AND CENTRAL CONTRACTOR REGISTRATION, Appendix A to Part 25 – Award Term

### II. 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;

- 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.
- May not make a subaward to an entity unless the entity has provided its DUNS number to you.

**Condition**

Health Care Services did not obtain DUNS numbers from its Block Grants for Community Mental Health Services (Mental Health) or Block Grants for Prevention and Treatment of Substance Abuse (SABG) subrecipients prior to awarding federal funds. Failure to obtain DUNS numbers increases the risk that subawards may be incorrectly reported.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Health Care Services should implement policies and procedures to ensure that it obtains DUNS numbers from Mental Health and SABG program subrecipients prior to approving the subaward.

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

Health Care Services agrees with the finding of not obtaining DUNS numbers from its Block Grant recipients for fiscal year 2013-14 and has taken corrective action to address this issue. KPMG began the fiscal year 2012-13 Audit of the MHBG in October 2013. In March 2014, KPMG released their report of audit findings stating that Mental Health did not obtain DUNS numbers from its Mental Health subrecipients prior to awarding federal funds. DHCS responded by stating that this policy would be implemented in its State Fiscal Year (SFY) 2014-15 Planning Estimate and Renewal Application for the MHBG. In January 2015, KPMG released its report, again citing the DUNS number finding for both fiscal year 2012-13 and FY 2013-14. This latter finding was the result of a slight time lag in the implementation of Department of Health Care Services (Health Care Services) DUNS number policy.

As of May 2014, Health Care Services implemented the policy to require counties to provide their DUNS number within their state fiscal year 2014-15 Planning Estimate and Renewal Application as stated in KPMG's audit report for fiscal year 2012-13 released March 2014. The application instructions require all participating Mental Health counties to provide their DUNS Number within their county application. On September 30, 2014, KPMG received the SFY 2014-15 Mental Health Application Cover Letter, as well as a scanned pdf document of a participating county's planning estimate worksheet with their DUNS number recorded as evidence that the DUNS finding was implemented from Health Care Services.

**Contact**

Kimberly Wimberly, Chief Grants Management Unit, Mental Health Services Division

**Implementation Date**

May 2014

## **Auditee's Section**

## **Schedule Of Expenditures Of Federal Awards Fiscal Year Ended June 30, 2014**

**STATE OF CALIFORNIA**  
**SCHEDULE OF EXPENDITURES**  
**OF FEDERAL AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>U.S. Department of Agriculture</b>				
Plant and Animal Disease, Pest Control, and Animal Care	10.025		\$ 54,633,612	\$ 28,319,198
Market Protection and Promotion	10.163		2,814,751	–
Specialty Crop Block Grant Program – Farm Bill	10.170		10,721,021	12,816,628
Organic Certification Cost Share Programs	10.171		2,331	–
Cooperative Agreements with States for Intrastate Meat and Poultry Inspection	10.475		185,325	–
Meat, Poultry, and Egg Products Inspection	10.477		71,088	25,124
Food Safety Cooperative Agreements	10.479		115,114	–
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557		1,087,117,477	268,321,635
Child and Adult Care Food Program	10.558		369,752,000	367,191,457
State Administrative Expenses for Child Nutrition	10.560		36,319,420	–
WIC Farmers' Market Nutrition Program (FMNP)	10.572		1,583,092	–
Senior Farmers Market Nutrition Program	10.576		772,966	693,074
Fresh Fruit and Vegetable Program	10.582		10,710,648	10,710,648
Technical Assistance for Speciality Crops Program	10.604		139,033	139,033
<i>Pass-Through from California Citrus Mutual</i>		95-313990	475,000	–
Cooperative Forestry Assistance	10.664		2,020,134	645,474
Urban and Community Forestry Program	10.675		768,928	–
Forest Legacy Program	10.676		336,578	3,889
Forest Stewardship Program	10.678		111,146	23,372
Forest Health Protection	10.680		386,726	281,230
ARRA – Recovery Act of 2009: Wildland Fire Management, Recovery Act Funded	10.688		18,666	–
Watershed Restoration and Enhancement Agreement Authority	10.693		148,651	–
Soil and Water Conservation	10.902		1,774	–
Long-Term Standing Agreements For Storage, Transportation, and Lease	10.999		14,132,063	–
<b>Total Excluding Clusters</b>			<b>1,593,337,544</b>	<b>689,170,762</b>
<b>SNAP Cluster</b>				
Supplemental Nutrition Assistance Program, Recovery Act Funded	10.551		7,476,937,642	–
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		894,176,191	708,447,461
<b>Total SNAP Cluster</b>			<b>8,371,113,833</b>	<b>708,447,461</b>
<b>Child Nutrition Cluster</b>				
School Breakfast Program	10.553		458,634,420	458,634,420
National School Lunch Program	10.555		1,422,860,077*	1,422,860,077
Special Milk Program for Children	10.556		360,891	360,891
Summer Food Service Program for Children	10.559		22,470,565	21,657,739
<b>Total Child Nutrition Cluster</b>			<b>1,904,325,953</b>	<b>1,903,513,127</b>
<b>Food Distribution Cluster</b>				
Commodity Supplemental Food Program	10.565		6,402,726*	6,402,726
Emergency Food Assistance Program (Administrative Costs)	10.568		10,095,476	9,582,270
<b>Total Food Distribution Cluster</b>			<b>16,498,202</b>	<b>15,984,996</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Forest Service Schools and Roads Cluster</b>				
Schools and Roads – Grants to States	10.665		\$ 32,703,151	\$ –
<b>Total Forest Service Schools and Roads Cluster</b>			<b>32,703,151</b>	<b>–</b>
<b>Research and Development Cluster</b>				
Plant and Animal Disease, Pest Control, and Animal Care	10.025		200,885	–
Specialty Crop Block Grant Program - Farm Bill	10.170		7,925,146	–
<b>Research and Development Cluster</b>			<b>8,126,031</b>	<b>–</b>
<b>Total U.S. Department of Agriculture</b>			<b>11,926,104,714</b>	<b>3,317,116,346</b>
<b>Department of Commerce</b>				
Interjurisdictional Fisheries Act of 1986	11.407		81,049	–
Coastal Zone Management Administration Awards	11.419		2,344,117	409,797
Coastal Zone Management Estuarine Research Reserves	11.420		869,087	561,534
<i>Pass-Through from Pacific States Marine Fisheries</i>		Unknown	753,686	–
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438		12,681,885	–
Regional Fishery Management Councils	11.441			
<i>Pass-Through from Pacific Fisheries Management Council</i>		Unknown	156,941	–
Habitat Conservation	11.463		951,185	751,904
Meteorologic and Hydrologic Modernization Development	11.467		699,546	–
State and Local Implementation Grant Program	11.549		224,035	–
ARRA – State Broadband Data and Development Grant Program, Recovery Act Funded	11.558		1,387,347	–
<b>Total Excluding Cluster</b>			<b>20,148,878</b>	<b>1,723,235</b>
<b>Research and Development Cluster</b>				
Unallied Management Projects	11.454		824,097	–
Unallied Science Program	11.472		69,734	–
<b>Research and Development Cluster</b>			<b>893,831</b>	<b>–</b>
<b>Total Department of Commerce</b>			<b>21,042,709</b>	<b>1,723,235</b>
<b>Department of Defense</b>				
Planning Assistance to States	12.110		1,717,034	–
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		16,633,602	–
Basic and Applied Scientific Research	12.300		100	–
National Guard Military Operations and Maintenance (O&M) Projects	12.401		78,523,556	–
National Guard Challenge Program	12.404		10,555,926	–
Community Economic Adjustment Assistance for Compatible Use and Joint Land Use Studies	12.610		107,453	–
Air Force Defense Research Sciences Program	12.800		8,827	–
Other - U.S. Department of Defense	12.999		1,396,771	–
<b>Total Department of Defense</b>			<b>108,943,269</b>	<b>–</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Department of Housing and Urban Development</b>				
Manufactured Home Dispute Resolution	14.171		\$ 235,971	\$ -
Emergency Solutions Grant Program	14.231		11,906,554	11,375,780
Home Investment Partnerships Program	14.239		44,140,029	39,891,926
Housing Opportunities for Persons with AIDS	14.241		3,296,741	-
Equal Opportunity in Housing	14.400		3,320,217	-
Lead-Based Paint Hazard Control in Privately-Owned Housing	14.900		804,884	688,734
<b>Total Excluding Clusters</b>			<b>63,704,396</b>	<b>51,956,440</b>
<b>CDBG – State Administered CDBG Cluster</b>				
Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii	14.228		45,519,317	42,629,605
<b>Total CDBG – State Administered CDBG Cluster</b>			<b>45,519,317</b>	<b>42,629,605</b>
<b>Housing Voucher Cluster</b>				
Section 8 Housing Choice Vouchers	14.871		3	-
<b>Total Housing Voucher Cluster</b>			<b>3</b>	<b>-</b>
<b>Total Department of Housing and Urban Development</b>			<b>109,223,716</b>	<b>94,586,045</b>
<b>Department of the Interior</b>				
National Fire Plan – Wildland Urban Interface Community Fire Assistance	15.228		250,300	-
Fish, Wildlife and Plant Conservation Resource Management	15.231		554,460	491,864
Southern Nevada Public Land Management	15.235		23,756	-
Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		256,413	-
ARRA – Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		(9,391)	-
Federal Oil and Gas Royalty Management State and Tribal Coordination	15.427		897,876	-
Minerals Leasing Act	15.437		84,836,013	-
Providing Water to At-Risk Natural Desert Terminal Lakes	15.508		106,208	-
Central Valley Project Improvement Act, Title XXXIV	15.512		3,511,147	-
Fish and Wildlife Coordination Act, Recovery Act Funded	15.517		132,553	-
Recreation Resources Management	15.524		3,103,972	-
Central Valley Project, Trinity River Division, Trinity River Fish and Wildlife Management	15.532		(488)	-
California Water Security and Environmental Enhancement	15.533		388,365	-
Lake Tahoe Regional Wetlands Development Program	15.543		288,632	-
San Joaquin River Restoration Program	15.555		481,508	-
Fish and Wildlife Management Assistance	15.608		10,196	-
Coastal Wetlands Planning, Protection and Restoration Act	15.614		1,269,273	1,269,273
Cooperative Endangered Species Conservation Fund	15.615		1,841,090*	-
Clean Vessel Act	15.616		1,066,570	553,240
Sportfishing and Boating Safety Act	15.622		297,750	297,750

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Enhanced Hunter Education and Safety Program	15.626		\$ 117,296	\$ -
Coastal Program	15.630		(32)	-
Landowner Incentive Program	15.633		83,511	-
State Wildlife Grants	15.634		734	-
Challenge Cost Share	15.642		(1,093)	-
Central Valley Project Improvement (CVPI) Anadromous Fish Restoration Program (AFRP)	15.648		286,491	-
Research Grants (Generic)	15.650		4,800	-
Endangered Species Conservation – Recovery Implementation Funds	15.657		316,857	-
Coastal Impact Assistance Program	15.668		3,222,479	3,129,171
National Wildlife Refuge Fund	15.669		1,233	-
Earthquake Hazards Reduction Program	15.807		87,089	-
U.S. Geological Survey – Research and Data Collection	15.808		17,848	-
National Spatial Data Infrastructure Cooperative Agreements Program	15.809		18,000	-
National Cooperative Geologic Mapping Program	15.810		181,251	-
National Geological and Geophysical Data Preservation Program	15.814		21,508	-
Historic Preservation Fund Grants-In-Aid	15.904		1,438,793	325,752
Outdoor Recreation – Acquisition, Development and Planning	15.916		1,626,623	1,220,700
ARRA – Abandoned Mine Hazard Mitigation, Recovery Act Funded	15.934		122,692	-
ARRA – Redwood National Park Cooperative Management with the State of California, Recovery Act Funded	15.937		23,417	-
Natural Resource Stewardship	15.944		41,011	-
Other – U.S. Department of the Interior	15.999		4,106,095	-
<b>Total Excluding Clusters</b>			<b>111,022,806</b>	<b>7,287,750</b>
<b>Fish and Wildlife Cluster</b>				
Sport Fish Restoration Program	15.605		3,911,637	-
Wildlife Restoration and Basic Hunter Education	15.611		9,189,420	-
<b>Total Fish and Wildlife Cluster</b>			<b>13,101,057</b>	-
<b>Research and Development Cluster</b>				
ARRA – Central Valley Project Improvement Act, Title XXXIV, Recovery Act Funded	15.512		2,102,004	-
San Luis Unit, Central Valley Project	15.527		39,861	-
California Water Security and Environmental Enhancement	15.533		202,756	-
San Joaquin River Restoration Program	15.555		53,501	-
Sport Fish Restoration Program	15.605		12,080,630	-
Fish and Wildlife Management Assistance	15.608		186,650	-
Wildlife Restoration and Basic Hunter Education	15.611		3,259,526	-
Cooperative Endangered Species Conservation Fund	15.615		3,004,322	-
State Wildlife Grants	15.634		1,982,619	-
Migratory Bird Conservation	15.647		11,812	-
Central Valley Project Improvement (CVPI) Anadromous Fish Restoration Program (AFRP)	15.648		59,286	-
Research Grants (Generic)	15.650		13,735	-
Technical Preservation Services	15.915		1,715	-



FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Total Research and Development Cluster</b>			<b>\$ 22,998,417</b>	<b>\$ -</b>
<b>Total Department of the Interior</b>			<b>147,122,280</b>	<b>7,287,750</b>
<b>Department of Justice</b>				
Law Enforcement Assistance - Narcotics and Dangerous Drugs – Laboratory Analysis	16.001		97,625	-
Sexual Assault Services Formula Program	16.017		441,859	441,859
Juvenile Accountability Block Grants	16.523		2,491,361	2,331,831
Juvenile Justice and Delinquency Prevention – Allocation to States	16.540		4,491,115	3,146,592
Part E – Developing, Testing, and Demonstrating Promising New Programs	16.541		10,410	1,590
National Criminal History Improvement Program (NCHIP)	16.554		253,296	-
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560		190,740	-
Crime Victim Assistance	16.575		43,854,439	42,163,722
Crime Victim Compensation	16.576		30,632,551	-
Drug Court Discretionary Grant Program	16.585		65,599	-
Violence Against Women Formula Grants, Recovery Act Funded	16.588		11,473,625	10,620,942
ARRA - Violence Against Women Formula Grants, Recovery Act Funded	16.588		3	-
Total Violence Against Women Formula Grant			11,473,628	10,620,942
Residential Substance Abuse Treatment for State Prisoners	16.593		1,763,972	1,587,797
Corrections_Research and Evaluation and Policy Formulation	16.602			
<i>Pass-Through from State Justice Institute</i>		SJI-10-1-173	365,000	-
State Criminal Alien Assistance Program	16.606		52,407,861	-
Bulletproof Vest Partnership Program	16.607		392,618	392,618
Project Safe Neighborhoods	16.609		203,752	154,745
<i>Pass-Through from Western States Information Network, Inc.</i>		Unknown	1,955,423	-
ARRA – Public Safety Partnership and Community Policing Grants, Recovery Act Funded	16.710		448,251	-
Enforcing Underage Drinking Laws Program	16.727		64,834	-
Protecting Inmates and Safeguarding Communities Discretionary Grant Program	16.735		82,485	67,137
DNA Backlog Reduction Program	16.741		4,157,364	989,163
Paul Coverdell Forensic Sciences Improvement Grant Program	16.742		813,291	702,515
Edward Byrne Memorial Competitive Grant Program	16.751		77,230	-
Economic High-Tech and Cyber Crime Prevention	16.752		48,895	-
Congressionally Recommended Awards	16.753		26,324	-
Harold Rogers Prescription Drug Monitoring Program	16.754		95,847	-
Second Chance Act Reentry Initiative	16.812		219,437	198,041
John R. Justice Prosecutors and Defenders Incentive Act	16.816		133,018	-
Equitable Sharing Program	16.922		1,477,746	-
Other - Department of Justice	16.999			
<i>Pass-Through from the State Justice Institute</i>		SJI-12-P082	36,638	-
<b>Total Excluding Clusters</b>			<b>158,772,609</b>	<b>62,798,552</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>JAG Program Cluster</b>				
Edward Byrne Memorial Justice Assistance Grant Program	16.738		\$ 13,680,600	\$ 12,204,588
ARRA – Recovery Act – Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories, Recovery Act Funded	16.803		261,424	–
<b>Total JAG Program Cluster</b>			<b>13,942,024</b>	<b>12,204,588</b>
<b>Total Department of Justice</b>				
			<b>172,714,633</b>	<b>75,003,140</b>
<b>Department of Labor</b>				
Labor Force Statistics	17.002		7,683,492	–
Compensation and Working Conditions	17.005		702,294	–
Unemployment Insurance, Recovery Act Funded	17.225		8,985,981,396	–
Senior Community Service Employment Program	17.235		7,219,167	6,803,499
Trade Adjustment Assistance	17.245		8,395,011	–
Workforce Investment Act (WIA) Dislocated Worker National Reserve Technical Assistance and Training	17.281		8,301	–
Work Opportunity Tax Credit Program (WOTC)	17.271		3,364,091	–
Temporary Labor Certification for Foreign Workers	17.273		1,942,981	–
ARRA – Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors, Recovery Act Funded	17.275		32,909	32,909
Workforce Investment Act (WIA) National Emergency Grants	17.277		3,025,055	2,785,456
Occupational Safety and Health – State Program	17.503		25,766,888	–
Consultation Agreements	17.504		4,592,921	–
Mine Health and Safety Grants	17.600		218,660	–
<b>Total Excluding Clusters</b>			<b>9,048,933,166</b>	<b>9,621,864</b>
<b>Employment Service Cluster</b>				
Employment Service/Wagner-Peyser Funded Activities	17.207		102,212,385	3,460,596
Disabled Veterans' Outreach Program (DVOP)	17.801		12,638,370	–
Local Veterans' Employment Representative Program	17.804		6,468,002	–
<b>Total Employment Service Cluster</b>			<b>121,318,757</b>	<b>3,460,596</b>
<b>WIA Cluster</b>				
WIA Adult Program	17.258		102,943,988	96,838,374
WIA Youth Activities	17.259		124,351,580	117,062,008
WIA Dislocated Worker Formula Grants	17.278		171,481,986	162,432,087
<b>Total WIA Cluster</b>			<b>398,777,554</b>	<b>376,332,469</b>
<b>Total Department of Labor</b>				
			<b>9,569,029,477</b>	<b>389,414,929</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Department of Transportation</b>				
Airport Improvement Program	20.106		\$ 598,486	\$ –
Highway Research and Development Program	20.200		19,406	–
Highway Training and Education	20.215		8,435	–
National Motor Carrier Safety	20.218		14,933,198	–
Performance and Registration Information Systems Management	20.231		37,514	–
Commercial Driver's License Program Improvement Grant	20.232		848,200	–
Fuel Tax Evasion – Intergovernmental Enforcement Effort	20.240		136,390	–
Railroad Safety	20.301		8,423,154	6,700,538
Capital Assistance to States – Intercity Passenger Rail Service	20.317		16,239,633	16,239,581
High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants, Recovery Act Funded	20.319		29,471,503	13,311,785
ARRA – High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants, Recovery Act Funded	20.319		310,063,547	9,846,363
Total High Speed Rail Corridors and Intercity Passenger Rail Service			339,535,050	23,158,148
Metropolitan Transportation Planning	20.505		63,050,131	63,050,131
Formula Grants for Rural Areas	20.509		27,977,094	26,710,724
ARRA – Formula Grants for Rural Areas, Recovery Act Funded	20.509		1,040,753	231,453
Total Formula Grants for Rural Areas			29,017,847	26,942,177
Public Transportation Research	20.514		14,510	–
Metropolitan Transportation Planning and State and Non-Metropolitan Planning and Research	20.515		963,431	–
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608		62,311,345	–
National Priority Safety Programs	20.616		7,279,119	–
Pipeline Safety Program State Base Grant	20.700		3,006,097	–
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703		1,675,764	225,635
<b>Total Excluding Clusters</b>			<b>548,097,710</b>	<b>136,316,210</b>
<b>Highway Planning and Construction Cluster</b>				
Highway Planning and Construction	20.205		3,538,134,064	1,425,191,125
ARRA – Highway Planning and Construction, Recovery Act Funded	20.205		46,460,546	9,174,839
Recreational Trails Program	20.219		2,944,588	2,501,259
<b>Total Highway Planning and Construction Cluster</b>			<b>3,587,539,198</b>	<b>1,436,867,223</b>
<b>Transit Services Programs Cluster</b>				
Enhanced Mobility of Seniors and Individuals with Disabilities	20.513		18,395,246	17,778,642
Job Access And Reverse Commute Program	20.516		3,926,896	3,749,958
New Freedom Program	20.521		2,492,563	2,331,819
<b>Total Transit Services Programs Cluster</b>			<b>24,814,705</b>	<b>23,860,419</b>
<b>Highway Safety Cluster</b>				
State and Community Highway Safety	20.600		21,322,417	–

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601		\$ 3,990,136	\$ —
Occupant Protection Incentive Grants	20.602		923,062	—
Safety Belt Performance Grants	20.609		257,434	—
State Traffic Safety Information System Improvement Grants	20.610		2,861,816	—
Incentive Grant Program to Increase Motorcyclist Safety	20.612		994,293	—
Child Safety and Child Booster Seats Incentive Grants	20.613		551,493	—
<b>Total Highway Safety Cluster</b>			<b>30,900,651</b>	<b>—</b>
<b>Research and Development Cluster</b>				
Highway Planning and Construction	20.205		15,761,737	—
Formula Grants for Rural Areas	20.509		85,389	—
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601		5,706	—
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608		134,121	—
National Priority Safety Programs	20.616		51,766	—
<b>Research and Development Cluster</b>			<b>16,038,719</b>	<b>—</b>
<b>Total Department of Transportation</b>			<b>4,207,390,983</b>	<b>1,597,043,852</b>
<b>Department of Treasury</b>				
National Foreclosure Mitigation Counseling	21.000		1,436,074	—
<b>Total Department of Treasury</b>			<b>1,436,074</b>	<b>—</b>
<b>Equal Opportunity Employment Commission</b>				
Other – Equal Opportunity Employment Commission	30.999		2,090,217	—
<b>Total Equal Opportunity Employment Commission</b>			<b>2,090,217</b>	<b>—</b>
<b>General Services Administration</b>				
Election Reform Payments	39.011		265,457	—
<b>Total General Services Administration</b>			<b>265,457</b>	<b>—</b>
<b>National Endowment for the Arts</b>				
Promotion of the Arts – Partnership Agreements	45.025		1,035,978	522,212
Grants to States	45.310		16,229,551	8,513,446
<b>Total National Endowment for the Arts</b>			<b>17,265,529</b>	<b>9,035,658</b>
<b>Small Business Administration</b>				
State Trade and Export Promotion Pilot Grant Program	59.061		1,807,530	1,664,284
<b>Total Small Business Administration</b>			<b>1,807,530</b>	<b>1,664,284</b>
<b>Department of Veterans Affairs</b>				
Grants to States for Construction of State Home Facilities	64.005		5,267,626	—

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Burial Expenses Allowance for Veterans	64.101		\$ 233,364	\$ -
All-Volunteer Force Educational Assistance	64.124		1,215,805	-
<b>Total Department of Veterans Affairs</b>			<b>6,716,795</b>	<b>-</b>
<b>Environmental Protection Agency</b>				
Air Pollution Control Program Support	66.001		5,384,164	-
State Indoor Radon Grants	66.032		129,191	-
Surveys, Studies, Research, Investigations, Demonstrations, and Special Purpose Activities Relating to the Clean Air Act	66.034		659,827	-
State Clean Diesel Grant Program, Recovery Act Funded	66.040		205,152	-
ARRA – State Diesel Clean Grant Program	66.040		454,899	-
The San Francisco Bay Water Quality Improvement Fund	66.126		114,051	81,986
State Environmental Justice Cooperative Agreement Program	66.312		46,531	-
Water Pollution Control State, Interstate, and Tribal Program Support	66.419		12,844,590	6,862,855
Pass-Through from San Jose State University Foundation		Unknown	525,390	-
State Public Water System Supervision	66.432		4,593,767	-
State Underground Water Source Protection	66.433		558,572	-
Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements – Section 104(b)(3) of the Clean Water Act	66.436		(1,575)	-
Urban Waters Small Grants	66.440		31,595	-
Water Quality Management Planning, Recovery Act Funded	66.454		837,339	246,574
ARRA – Water Quality Management Planning	66.454		47,243	-
Nonpoint Source Implementation Grants	66.460		10,373,915	5,280,759
Regional Wetland Program Development Grants	66.461		7,149	7,149
Beach Monitoring and Notification Program Implementation Grants	66.472		445,034	324,144
Performance Partnership Grants	66.605		1,273,047	-
Environmental Information Exchange Network Grant Program and Related Assistance	66.608		228,625	-
Consolidated Pesticide Enforcement Cooperative Agreements	66.700		(1,520)	-
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	66.707		561,471	-
Hazardous Waste Management State Program Support	66.801		6,493,545	-
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements, Recovery Act Funded	66.802		1,018,880	-
Underground Storage Tank Prevention, Detection and Compliance Program	66.804		1,012,106	724,973
Leaking Underground Storage Tank Trust Fund Corrective Action Program, Recovery Act Funded	66.805		2,677,089	-
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809		29,478	-
Brownfields Training, Research, and Technical Assistance Grants and Cooperative Agreements	66.814		93,670	-
State and Tribal Response Program Grants	66.817		1,218,603	-
Brownfields Assessment and Cleanup Cooperative Agreements, Recovery Act Funded	66.818		436,141	393,445
Other - Environmental Protection Agency	66.999		85,000	-
<b>Total Excluding Cluster</b>			<b>52,382,969</b>	<b>13,921,885</b>

**Research and Development Cluster**

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements, Recovery Act Funded	66.802		\$ 44,552	\$ –
<b>Research and Development Cluster</b>			<b>44,552</b>	<b>–</b>
<b>Total Environmental Protection Agency</b>			<b>52,427,521</b>	<b>13,921,885</b>
<b>Department of Energy</b>				
State Energy Program	81.041		2,285,882	–
ARRA – State Energy Program, Recovery Act Funded	81.041		817,828	644,459
Total State Energy Program			3,103,710	644,459
Weatherization Assistance for Low-Income Persons	81.042		2,777,324	2,676,708
Nuclear Waste Disposal Siting	81.065		827,317	–
ARRA – Conservation Research and Development, Recovery Act Funded	81.086		225,180	–
Renewable Energy Research and Development	81.087		96,778	80,000
Fossil Energy Research and Development	81.089		(813,441)	(816,151)
Environmental Remediation and Waste Processing and Disposal	81.104		244,623	–
State Energy Program Special Projects	81.119		455,570	381,648
ARRA – Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded	81.122		1,593,318	1,209,320
ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG), Recovery Act Funded	81.128		397,144	340,258
Long-Term Surveillance and Maintenance	81.136		25,047	–
Environmental Monitoring/Cleanup, Cultural and Resource Mgmt., Emergency Response Research, Outreach, Technical Analysis	81.214		66,567	–
<b>Total Department of Energy</b>			<b>8,999,137</b>	<b>4,516,242</b>
<b>Department of Education</b>				
Adult Education – Basic Grants to States	84.002		81,501,710	78,428,296
Migrant Education – State Grant Program	84.011		94,194,696	85,291,027
Title I State Agency Program for Neglected and Delinquent Children and Youth	84.013		1,375,743	1,361,327
Career and Technical Education – Basic Grants to States	84.048		119,222,532	109,435,956
Rehabilitation Services – Client Assistance Program	84.161		420,985	–
Independent Living – State Grants	84.169		2,372,264	950,779
Rehabilitation Services – Independent Living Services for Older Individuals Who are Blind	84.177		3,236,236	3,034,778
Safe and Drug-Free Schools and Communities – National Programs	84.184		13,431,064	11,956,592
Supported Employment Services for Individuals with the Most Significant Disabilities	84.187		2,880,772	–
Education for Homeless Children and Youth	84.196		8,069,830	7,701,012
Assistive Technology	84.224		918,317	–
Pass-Through from University of Florida			25,000	–

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Rehabilitation Training – State Vocational Rehabilitation Unit In-Service Training	84.265		\$ 305,266	\$ –
Charter Schools	84.282		33,130,039	31,188,052
Twenty-First Century Community Learning Centers	84.287		123,963,991	120,980,101
Special Education – State Personnel Development	84.323		1,920,452	1,916,310
Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	84.330		10,146,049	10,146,049
Rural Education	84.358		1,244,913	1,204,098
English Language Acquisition State Grants	84.365		145,324,837	140,357,102
Mathematics and Science Partnerships	84.366		15,899,388	15,095,790
Improving Teacher Quality State Grants	84.367		283,054,185	277,020,295
Grants for State Assessments and Related Activities	84.369		34,558,929	25,460,792
Striving Readers	84.371		3,569	–
College Access Challenge Grant Program	84.378		14,019,718	13,843,598
Race to the Top – Early Learning Challenge	84.412		19,662,005	16,206,557
Promoting Readiness of Minors in Supplemental Security Income	84.418		603,094	–
<b>Total Excluding Clusters</b>			<b>1,011,485,584</b>	<b>951,578,511</b>
<b>Title I, Part A Cluster</b>				
Title I Grants to Local Educational Agencies	84.010		1,514,206,352	1,497,871,053
<b>Total Title I, Part A Cluster</b>			<b>1,514,206,352</b>	<b>1,497,871,053</b>
<b>Special Education Cluster (IDEA)</b>				
Special Education – Grants to States	84.027		1,421,587,438	1,388,408,672
Special Education – Preschool Grants	84.173		40,247,196	38,579,937
<b>Total Special Education Cluster (IDEA)</b>			<b>1,461,834,634</b>	<b>1,426,988,609</b>
<b>Vocational Rehabilitation Cluster</b>				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		291,989,934	–
<b>Total Vocational Rehabilitation Cluster</b>			<b>291,989,934</b>	<b>–</b>
<b>Early Intervention Services (IDEA) Cluster</b>				
Special Education-Grants for Infants and Families	84.181		60,290,702	60,290,702
<b>Total Early Intervention Services (IDEA) Cluster</b>			<b>60,290,702</b>	<b>60,290,702</b>
<b>Educational Technology State Grants Cluster</b>				
Educational Technology State Grants	84.318		(328)	–
<b>Total Educational Technology State Grants Cluster</b>			<b>(328)</b>	<b>–</b>
<b>School Improvement Grants Cluster</b>				
School Improvement Grants	84.377		49,166,636	48,748,856
ARRA – School Improvement Grants, Recovery Act Funded	84.388		53,870,272	53,870,272
<b>Total School Improvement Grants Cluster</b>			<b>103,036,908</b>	<b>102,619,128</b>
<b>Total Department of Education</b>			<b>4,442,843,786</b>	<b>4,039,348,003</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>U.S. Election Assistance Commission</b>				
Help America Vote Act Requirements Payments	90.401		\$ 16,405,897	\$ -
U.S. Election Assistance Commission Research Grants	90.403		13,765	-
<b>Total U.S. Election Assistance Commission</b>			<b>16,419,662</b>	<b>-</b>
<b>Department of Health and Human Services</b>				
State and Territorial and Technical Assistance Capacity Development Minority HIV/ AIDS Demonstration Program	93.006		341	-
Strengthening Public Health Services at the Outreach Offices of the U.S.-Mexico Border Health Commission	93.018		253,561	-
Special Programs for the Aging – Title VII, Chapter 3 – Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041		537,331	536,331
Special Programs for the Aging – Title VII, Chapter 2 – Long-Term Care Ombudsman Services for Older Individuals	93.042		1,408,970	1,330,958
Special Programs for the Aging – Title III, Part D – Disease Prevention and Health Promotion Services	93.043		1,992,224	1,992,224
Special Programs for the Aging – Title IV – and Title II – Discretionary Projects, Recovery Act Funded	93.048		98,778	28,580
Alzheimer’s Disease Demonstration Grants to States*	93.051		94,312	94,312
National Family Caregiver Support, Title III, Part E	93.052		14,009,188	13,414,301
Public Health Emergency Preparedness	93.069		822,042	-
Environmental Public Health and Emergency Response	93.070		134,545	-
Medicare Enrollment Assistance Program	93.071		124,204	124,204
Hospital Preparedness Program (HPP) and Public Health Emergency Preparedness (PHEP) Aligned Cooperative Agreements	93.074		68,306,130	-
Systems Interoperability – Health and Human Services	93.075		488,240	-
Cooperative Agreements to Promote Adolescent Health through School-Based HIV/STD Prevention and School-Based Surveillance	93.079		214,599	-
Emergency System for Advance Registration of Volunteer Health Professionals	93.089		343,437	-
ARRA – Guardianship Assistance, Recovery Act Funded	93.090		33,453,022	33,393,393
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		6,184,972	-
Well-Integrated Screening and Evaluation for Women Across the Nation	93.094		403,297	-
Food and Drug Administration – Research	93.103		1,188,957	-
Maternal and Child Health Federal Consolidated Programs	93.110		212,324	-
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		7,601,580*	-
Emergency Medical Services for Children	93.127		133,443	-
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	93.130		307,417	-
Centers for Research and Demonstration for Health Promotion and Disease Prevention	93.135		774,754	-
Injury Prevention and Control Research and State and Community Based Programs	93.136		4,127,280	-
Projects for Assistance in Transition from Homelessness (PATH)	93.150		8,548,483	-
Health Program for Toxic Substances and Disease Registry	93.161		801,283	-
Grants to States for Loan Repayment Program	93.165		1,129,871	1,129,871
Grants to States to Support Oral Health Workforce Activities	93.236		1,257,087	-



FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
State Rural Hospital Flexibility Program	93.241		\$ 555,768	\$ -
Substance Abuse and Mental Health Services – Projects of Regional and National Significance	93.243		(1,587,675)	-
Universal Newborn Hearing Screening	93.251		202,504	58,119
Adult Viral Hepatitis Prevention and Control	93.270		168,274	-
Substance Abuse and Mental Health Services – Access to Recovery Centers for Disease Control and Prevention – Investigations and Technical Assistance	93.275		2,534,784	-
	93.283		11,170,693	2,922,928
Small Rural Hospital Improvement Grant Program	93.301		363,449	-
State Health Insurance Assistance Program	93.324		486,709	340,634
ARRA – State Loan Repayment Program, Recovery Act Funded	93.402		1,394,947	1,394,947
ARRA – State Primary Care Offices, Recovery Act Funded	93.414		242,183	165,805
Food Safety and Security Monitoring Project	93.448		223,243	-
ARRA – Pregnancy Assistance Fund Program, Recovery Act Funded	93.500		1,252,019	-
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505		10,654,644	-
ACA Nationwide Program for National and State Background Checks for Direct Patient Access Employees of Long Term Care Facilities and Providers	93.506		875,599	-
PPHF 2012 National Public Health Improvement Initiative	93.507		989,591	-
Affordable Care Act (ACA) Grants to States for Health Insurance Premium Review	93.511		1,157,040	-
Affordable Care Act (ACA) Personal and Home Care Aide State Training Program (PHCAST)	93.512		356,467	354,123
Affordable Care Act – Aging and Disability Resource Center	93.517		62,416	-
Affordable Care Act (ACA) – Consumer Assistance Program Grants	93.519		2,690,457	-
Pre-existing Condition Insurance Program (PCIP)	93.529		6,664,561	-
Pass-Through from Public Health Institute		Unknown	2,025,687	-
Pass-Through from Department of Health Benefit Exchange		4800	622,000	-
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		750,821	-
The Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) authorizes Coordinated Chronic Disease prevention and Health Promotion Program	93.544		820,430	-
PPHF2013: State Nutrition, Physical Activity, and Obesity Programs – financed in part by 2013 PPHF	93.548		82,739	-
Promoting Safe and Stable Families	93.556		32,063,036	28,928,180
Child Support Enforcement	93.563		640,494,152	496,175,527
Child Support Enforcement Research	93.564		46,602	46,602
Refugee and Entrant Assistance – State Administered Programs	93.566		36,438,948	14,993,652
Low-Income Home Energy Assistance	93.568		182,616,596	172,840,337
Refugee and Entrant Assistance – Discretionary Grants	93.576		1,876,775	1,580,367
U.S. Repatriation	93.579		3,479	-
Refugee and Entrant Assistance – Targeted Assistance Grants	93.584		5,093,255	4,983,729
State Court Improvement Program	93.586		2,300,526	-
Community-Based Child Abuse Prevention Grants	93.590		4,260,662	2,197,005
Grants to States for Access and Visitation Programs	93.597		250,881	-
Chafee Education and Training Vouchers Program (ETV)	93.599		5,628,041	-
Adoption Incentive Payments	93.603		-	-

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The Affordable Care Act – Medicaid Adult Quality Grants	93.609		\$ 576,472	\$ –
Voting Access for Individuals with Disabilities – Grants to States	93.617		607,810	–
ACA – State Innovation Models: Funding for Model Design and Model Testing Assistance	93.624		1,317,352	–
Affordable Care Act State Health Insurance Assistance Program (SHIP) and Aging and Disability Resource Center (ADRC) Options Counseling for Medicare-Medicaid Individuals in States with Approved Financial Alignment Models	93.626		141,580	141,580
Affordable Care Act Implementation Support for State Demonstrations to Integrate Care for Medicare-Medicaid Enrollees	93.628		2,077,500	–
Developmental Disabilities Basic Support and Advocacy Grants	93.630		6,737,274	–
ACA Support for Demonstration Ombudsman Programs Serving Beneficiaries of State Demonstrations to Integrate Care for Medicare-Medicaid	93.634		130	–
Children's Justice Grants to States	93.643		1,817,684	1,654,647
Stephanie Tubbs Jones Child Welfare Services Program	93.645		23,701,090	23,701,090
Child Welfare Research Training or Demonstration	93.648		1,821,854	1,455,040
Foster Care – Title IV-E, Recovery Act Funded	93.658		1,219,135,004	1,166,779,514
ARRA – Foster Care – Title IV-E	93.658		(3,753)	(3,753)
Total Foster Care – Title IV-E			1,219,131,251	1,166,775,761
Adoption Assistance, Recovery Act Funded	93.659		444,037,523	428,607,248
ARRA – Adoption Assistance	93.659		(5,743)	(5,743)
Total Adoption Assistance			444,031,780	428,601,505
Social Services Block Grant	93.667		593,547,289	316,150,809
Child Abuse and Neglect State Grants	93.669		2,399,845	81,607
Family Violence Prevention and Services/Grants for Battered Women's Shelters – Grants to States and Indian Tribes	93.671		7,163,525	6,747,434
Chafee Foster Care Independence Program	93.674		20,884,896	19,640,957
ARRA – Prevention and Wellness – State, Territories and Pacific Islands	93.723		(1,149)	–
ARRA – Prevention and Wellness – Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)	93.724		23,609	–
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		95,281	–
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		661,533	637,696
State Public Health Approaches for Ensuring Quitline Capacity – Funded in part by 2012 Prevention and Public Health Funds (PPHF-2012)	93.735		2,825,979	–
Breast and Cervical Cancer Screening Opportunities through the National Breast and Cervical Cancer Early Detection Program NBCCEDP-PPHF Funds	93.744		538,808	–
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		1,593	–
Children's Health Insurance Program	93.767		1,507,300,547	–
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		3,574,827	2,882,635
Money Follows the Person Rebalancing Demonstration	93.791		19,372,475	–

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
National Bioterrorism Hospital Preparedness Program	93.889		\$ 3,517,259	\$ –
Grants to States for Operation of Offices of Rural Health	93.913		174,197	–
HIV Care Formula Grants	93.917		137,354,570	23,766,884
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938		31,861	–
HIV Prevention Activities – Health Department Based	93.940		16,257,158	–
ARRA - Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	93.943		(2,047)	–
Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944		2,268,478	–
Assistance Programs for Chronic Disease Prevention and Control	93.945		1,940,421	–
Tuberculosis Demonstration, Research, Public and Professional Education	93.947		42,767	–
Block Grants for Community Mental Health Services	93.958		52,038,271	–
Block Grants for Prevention and Treatment of Substance Abuse	93.959		274,293,262	258,553,959
Preventive Health Services – Sexually Transmitted Diseases Control Grants	93.977		4,839,223	–
Preventive Health and Health Services Block Grant	93.991		5,359,706	–
Maternal and Child Health Services Block Grant to the States	93.994		24,484,740	–
Other-Department of Health and Human Services	93.999		30,924,612	–
<b>Total Excluding Clusters</b>			<b>5,524,659,288</b>	<b>3,029,817,733</b>
<b>Aging Cluster</b>				
Special Programs for the Aging – Title III, Part B – Grants for Supportive Services and Senior Centers	93.044		33,704,271	31,279,990
Special Programs for the Aging – Title III, Part C – Nutrition Services	93.045		52,698,731	50,678,155
Nutrition Services Incentive Program	93.053		9,897,591	9,897,591
<b>Total Aging Cluster</b>			<b>96,300,593</b>	<b>91,855,736</b>
<b>Immunization Cluster</b>				
Immunization Cooperative Agreements	93.268		20,648,380*	–
<b>Total Immunization Cluster</b>			<b>20,648,380</b>	<b>–</b>
<b>TANF Cluster</b>				
Temporary Assistance for Needy Families	93.558		3,139,192,944	2,521,535,009
ARRA – Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program, Recovery Act Funded	93.714		14,463,370	14,463,370
<b>Total TANF Cluster</b>			<b>3,153,656,314</b>	<b>2,535,998,379</b>
<b>CSBG Cluster</b>				
Community Services Block Grant	93.569		56,395,742	53,197,930
<b>Total CSBG Cluster</b>			<b>56,395,742</b>	<b>53,197,930</b>
<b>CCDF Cluster</b>				
Child Care and Development Block Grant	93.575		258,253,020	258,253,020
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		299,167,820	287,684,934
<b>Total CCDF Cluster</b>			<b>557,420,840</b>	<b>545,937,954</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Head Start Cluster</b>				
Head Start	93.600		\$ 224,498	\$ —
ARRA – Head Start, Recovery Act Funded	93.708		5,373,202	5,376,248
<b>Total Head Start Cluster</b>			<b>5,597,700</b>	<b>5,376,248</b>
<b>Medicaid Cluster</b>				
State Medicaid Fraud Control Units	93.775		21,050,787	—
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	93.777		42,032,561	—
Medical Assistance Program	93.778		34,672,501,723	6,613,427,490
<b>Total Medicaid Cluster</b>			<b>34,735,585,071</b>	<b>6,613,427,490</b>
<b>Total Department of Health and Human Services</b>			<b>44,150,263,928</b>	<b>12,875,611,470</b>
<b>Corporation for National and Community Service</b>				
State Commissions	94.003		510,059	—
AmeriCorps, Recovery Act Funded	94.006		23,459,245	23,300,244
Program Development and Innovation Grants	94.007		11,418	—
Training and Technical Assistance	94.009		35,756	—
Volunteer Generation Fund	94.021		410,367	—
<b>Total Excluding Clusters</b>			<b>24,426,845</b>	<b>23,300,244</b>
<b>Foster Grandparent/Senior Companion Cluster</b>				
Foster Grandparent Program	94.011		1,221,934	991,328
<b>Total Foster Grandparent/Senior Companion Cluster</b>			<b>1,221,934</b>	<b>991,328</b>
<b>Total Corporation for National and Community Service</b>			<b>25,648,779</b>	<b>24,291,572</b>
<b>Executive Office of the President</b>				
High Intensity Drug Trafficking Areas Program	95.001			
Pass-Through from INCH/LA Police Chief's Association/Riverside County		Unknown	47,092	—
Pass-Through from INCH/LA Police Chief's Association/Riverside County		Unknown	41,899	—
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		Unknown	117,340	—
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		Unknown	1,055,633	—
Pass-Through from CV HIDTA/LA Police Chief's Association/Sacramento County		Unknown	2,293	—
Pass-Through from CV HIDTA/LA Police Chief's Association/Sacramento County		Unknown	45,522	—
Pass-Through from CV HIDTA/LA Police Chief's Association/Sacramento County		Unknown	11,603	—
Pass-Through from CA Border Alliance Group/City of San Diego/San Diego Police Dept (BI)		Unknown	119,560	—
Pass-Through from CA Border Alliance Group/City of San Diego/San Diego Police Dept (BI)		Unknown	831,142	—
Pass-Through from CA Border Alliance Group/City of San Diego/San Diego Police Dept (BI)		Unknown	259,780	—
<b>Total Executive Office of the President</b>			<b>2,531,864</b>	<b>—</b>

FEDERAL AGENCY/PROGRAM TITLE/ PASS-THROUGH ENTITY OR PROGRAM	FEDERAL CATALOG NUMBER	PASS- THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES	AMOUNTS PASSED THROUGH TO SUBRECIPIENTS
<b>Social Security Administration</b>				
<b>Disability Insurance/SSI Cluster</b>				
Social Security – Disability Insurance	96.001		\$ 215,434,303	\$ –
<b>Total Social Security Administration</b>			<b>215,434,303</b>	<b>–</b>
<b>Department of Homeland Security</b>				
Non-Profit Security Program	97.008		2,568,758	2,400,380
Boating Safety Financial Assistance	97.012		5,089,487	1,376,731
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023		459,370	–
Flood Mitigation Assistance	97.029		889,270	774,571
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036		74,054,031	69,706,777
Hazard Mitigation Grant	97.039		8,957,383	7,654,007
National Dam Safety Program	97.041		107,981	–
Emergency Management Performance Grants	97.042		30,697,503	16,740,912
State Fire Training Systems Grants	97.043		16,900	–
Cooperating Technical Partners	97.045		508,214	–
Fire Management Assistance Grant	97.046		12,981,451	12,677,548
Pre-Disaster Mitigation	97.047		2,393,358	1,991,826
Emergency Operations Center	97.052		1,835,214	1,835,214
Homeland Security Grant Program	97.067		280,674,682	259,657,072
Pass-Through from San Diego Sheriff's Department		Unknown	544,487	–
Pass-Through from Imperial County		Unknown	646,205	–
Pass-Through from Sacramento County Sheriff's Department		Unknown	160,161	–
Pass-Through from Imperial County		Unknown	55,821	–
Pass-Through from San Diego County Sheriff's Department		Unknown	54,750	–
Pass-Through from San Diego County Sheriff's Department		Unknown	46,347	–
<b>Total Homeland Security Grant Program</b>			<b>282,182,453</b>	<b>259,657,072</b>
Rail and Transit Security Grant Program	97.075		20,501,040	20,453,780
Buffer Zone Protection Program (BZPP)	97.078		(9)	–
Earthquake Consortium	97.082		227,618	138,916
Driver's License Security Grant Program	97.089		451,000	–
Severe Repetitive Loss Program	97.110		901,645	833,535
Regional Catastrophic Preparedness Grant Program (RCPGP)	97.111		5,120,614	5,120,614
Border Interoperability Demonstration Project	97.120		1,094,097	1,029,512
Other – Department of Homeland Security	97.999		50,000	–
<b>Total Department of Homeland Security</b>			<b>451,087,378</b>	<b>402,391,395</b>
<b>Total Expenditures of Federal Awards</b>			<b>75,656,809,741</b>	<b>22,852,955,806</b>

\*This program has noncash federal assistance, which may include a variety of items such as commodities, vaccines, or federal excess property. For the value of the assistance, see Note 3

## **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, 2014

#### 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 for the fiscal year ended June 30, 2014, 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 Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, a component unit of the State of California, which received \$5.4 billion, \$2.4 billion, \$102.3 million, \$211.5 million, and \$59.7 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. 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, 2014 are as follows:

FEDERAL CATALOG NUMBER	PROGRAM	NONCASH AWARDS FOR THE YEAR ENDED JUNE 30, 2014
10.555	National School Lunch Program	\$ 156,652,842
10.565	Commodity Supplemental Food Program	18,111,883
10.569	Emergency Food Assistance Program (Food Commodities)	62,082,110
15.615	Cooperative Endangered Species Conservation Fund	393,750
39.003	Donation of Federal Surplus Personal Property	76,032,420
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	445,545
93.268	Immunization Cooperative Agreements	419,007,817
94.031	Volunteers in Service to America	84,700
None **	Upper Truckee River Sunset Stables Reach 5	493,077
<b>Total</b>		<b>\$733,304,144</b>

\*\* 08-CS-11051900-018 Participating Agreement with USDA Forest Service

#### 4. LOANS, LOAN GUARANTEES OUTSTANDING, AND INSURANCE IN EFFECT

Loans, loan guarantees outstanding and insurance in effect at June 30, 2014 are summarized below:

FEDERAL CATALOG NUMBER	PROGRAM	LOANS/LOAN GUARANTEES OUTSTANDING AT JUNE 30, 2014	INSURANCE IN EFFECT AT JUNE 30, 2014
81.041	State Energy Program	\$ 1,750,521	
66.818	Brownfield Assessment and Cleanup Cooperative Agreements	961,698	
64.114	Veterans Housing-Guaranteed and Insured Loans		70,342,849
	<b>Total</b>	<b>\$ 2,712,219</b>	<b>\$ 70,342,849</b>

#### 5. PASS-THROUGH

Federal awards received by the State from a pass-through entity are included in the Schedule and are italicized.

#### 6. SUBRECIPIENTS

Amounts provided to subrecipients from each federal program are included in a separate column on the Schedule.

#### 7. 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:	2013-002
Federal Program:	10.551
State Administering Department:	Department of Social Services (Social Services)
Audit Finding:	<u>Subrecipient Monitoring</u> ; Special Tests and Provisions. Social Services did not formally communicate to county welfare system consortia and to county welfare departments that certain federal compliance requirements related to the State automated welfare systems and Electronic Benefit Transfers (EBT) cards were to be addressed in the county Office of Management and Budget (OMB) Circular A-133 audits. Social Services is to work with the U.S. Department of Agriculture (USDA) to determine how applicable Supplemental Nutrition Assistance Program (SNAP) compliance requirements are covered in county OMB Circular A-133 audits and obtain approval of its determination from USDA.
Status of Corrective Action:	Fully 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 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. USDA sent Social Services a letter dated August 26, 2014 confirming acceptance of the June 28, 2013 All County Welfare Directors Letter.
Reference Number:	2013-003
Federal Program:	10.553 10.555
State Administering Department:	California Department of Education (Education)
Audit Finding:	<u>Procurement; Subrecipient Monitoring</u> . Education did not implement appropriate internal controls and procedures to ensure that the approval process of food service management company (FSMC) contracts was documented prior to reimbursing subrecipients.
Status of Corrective Action:	Fully Corrected. Education received and reviewed 74 FSMC contracts and contract extensions for the 2014-15 school year. Education required school food authorities that are operating under extensions of their original FSMC contract to correct problems identified in their original procurement process through amendments. Further, Education has created a tracking system to monitor, review new and existing contracts, and provide bid reminders when needed.

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Reference Number: 2013-004

Federal Program: 10.553  
10.555

State Administering Department: California Department of Education (Education)

Audit Finding: Reporting; Subrecipient Monitoring. Education failed to properly implement or design information technology controls over logical access on the Education Child Nutrition Information and Payment System (CNIPS). Control deficiencies identified include unauthorized system approval; active user access for individuals no longer employed by Education; inconsistent user access reviews; and segregation of duties conflicts. Failure to maintain adequate information technology controls over logical access could result in improper reimbursements from the federal government.

Status of Corrective Action: Fully Corrected.

Education implemented a process to address the control deficiencies identified by reviewing system user access to ensure access is granted only to authorized officials; reviewing logs and deleting obsolete accounts; conducting quarterly reviews of user access; and segregating employee duties.

Auditors' Comment: We do not believe the issue has been fully corrected and have issued finding number 2014-002.

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Reference Number: 2013-005

Federal Program: 10.557

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

Audit Finding: Eligibility. Public Health failed to ensure local agencies 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 Woman, Infants, and Children (WIC) program using the Integrated Statewide Information Systems (ISIS). In three cases, eligibility information was not obtained or evidenced in the ISIS. As a result, it could not be determined whether the participants were eligible to receive benefits. Lack of policies and procedures may cause payments to be made to ineligible participants.

Status of Corrective Action: Partially Corrected.

The WIC program has procedures in place to monitor and evaluate the local agencies' (LAs) compliance with eligibility requirements and documentation policies. Public Health 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. The WIC program monitors the LA to ensure the finding is resolved. Further, the WIC program has contacted the LAs to provide additional technical assistance in the areas identified in the audit findings.

In two of the three cases of ineligibility, the WIC program was able to verify with the LA that it made the corrections during the certification period. In the other case, the WIC program allows for exemptions in certain circumstances. However, WIC program staff continue to provide ongoing technical assistance to ensure the LAs successfully resolve findings in order to ensure compliance with the eligibility requirements.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-003.

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Reference Number: 2013-006

Federal Program: 10.557

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

Audit Finding: Eligibility: Special Tests and Provisions. Information technology (IT) controls for Public Health's ISIS were not properly designed. Certain IT controls over logical access were not properly designed and implemented. Public Health uses the system to determine eligibility for the WIC program.

Control deficiencies identified include the following: active user access for individuals terminated by Public Health; lack of user access reviews; and improper restricted access. Additionally, it was identified the cost reports generated from ISIS appear to double count certain food instruments.

Status of Corrective Action: Partially Corrected.

Public Health is in the process of revising the existing intake forms for the creation of ISIS IDs. Updates and revisions to the instructions for the handling of ISIS logon IDs have been completed. Completion of the screening process and distribution of the refreshed instructions to the LAs remains to be completed. The cost report problems were resolved and ISIS is no longer double counting food instruments.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-004.

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Reference Number: 2013-007

Federal Program: 10.557

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

**Audit Finding:** Subrecipient Monitoring. Public Health did not ensure that subrecipients have a financial management review performed during the last two years required by the State Plan. Subrecipients determine eligibility and 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 a financial management review. Of the management reviews performed in 2012-13, nine had findings which required issuance of notice of the findings to the subrecipient. Failure to conduct required financial management reviews and issue audit finding letters increases the risk subrecipients are using federal funds for unallowable costs or activities.

**Status of Corrective Action:** Partially Corrected.

Audit work assignments and WIC staff have been reorganized to more effectively meet the program requirements. Additional staff positions were transferred to oversee the local agency financial management reviews. As of March 31, 2014, all notices of audit findings are current and are being issued within the required 90 days.

**Auditors' Comment:** We reported a similar finding in the 2014 audit. Please refer to finding 2014-005.

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**Reference Number:** 2013-008

10.557

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

**Audit Finding:** Subrecipient Monitoring. Public Health did not properly monitor its contract with the State Controller's Office (SCO). Public Health contracts with SCO to review subrecipient OMB Circular A-133 reports and issue management decisions on audit findings for the WIC program. Findings were identified for the WIC program; however, SCO did not issue a management decision letter timely. Failure to properly follow up on audit findings increases the risk that subrecipients may inappropriately use federal funds or grant benefits to ineligible participants.

**Status of Corrective Action:** Partially Corrected.

The identified management decision letters were issued by March 31, 2014 and the letters continue to be issued timely. In addition, discussions will occur between Public Health and SCO to provide clarifying contract language. Completion of negotiations and implementation of an amendment to the Public Health and SCO contract remains to be completed. However, Public Health's audit work assignments, as well as WIC staff, have been reorganized to more effectively meet the program's requirements. Workload associated with subrecipient audit reports, along with additional staff positions, were transferred to oversee the subrecipient financial review process.

**Auditors' Comment:** The finding was not repeated in the 2014 audit as Public Health has taken sufficient action to address the finding.

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Reference Number: 2013-009

Federal Program: 10.557

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

Audit Finding: Special Tests and Provisions. Public Health lacked adequate controls and policies and procedures to ensure it took appropriate action on findings identified during vendor inventory audits. Further, Public Health failed to issue notices of audit findings within the required 90 day issuance period. This increases the risk that vendors may inappropriately redeem food instruments and the state will not reclaim monies owed.

Status of Corrective Action: Partially Corrected.

All notices of audit findings are current and issued in the required 90 days. The WIC program has developed policies and procedures to ensure audit findings are issued within 90 days of completion.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-007.

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Reference Number: 2013-010

Federal Program: 10.565  
10.568  
10.569

State Administering Department: Department of Social Services (Social Services), California Department of Education (Education)

Audit Finding: Subrecipient Monitoring. Social Services and Education lack adequate policies and procedures to monitor subrecipients in accordance with federal requirements. Both departments administer the Food Distribution Cluster through Eligible Recipient Agencies (ERA) and local agencies.

- Education did not obtain Data Universal Numbering System (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.

Status of Corrective Action:	<p>Education: Fully Corrected.</p> <p>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 of the CSFP participating agencies.</p> <p>Social Services: Partially Corrected.</p> <p>Social Services plans to complete revisions to existing policies and procedures to monitor and follow-up on the OMB Circular A-133 audits by June 30, 2015. Social Services will request ERA to submit their latest A-133 operating year audit by September 30, 2014. If there are audit findings regarding Emergency Food Assistance Program, a "Management Decision Letter" will be completed within six months from receipt of the audit.</p>
Auditors' Comment:	<p>The finding was not repeated in the 2014 audit as Social Services has taken sufficient action to address the finding.</p>
Reference Number:	2013-011
Federal Program:	10.565
State Administering Department:	California Department of Education (Education)
Audit Finding:	<p><u>Reporting.</u> Education lacks adequate controls to ensure accuracy of Food and Nutrition Service (FNS-153) reports submitted for the Food Distribution Cluster, including reconciliation to supporting documents. Education did not accurately report outlays or unliquidated obligations. Failure to reconcile reports to supporting documents increases the risk of errors in information reported to the federal government.</p>

Status of Corrective Action:

Fully Corrected.

To ensure the accuracy of FNS-153 reports, Education's internal controls include the following data review and validation procedures:

- Local Agency reports are combined into a single state report by two CSFP staff members: one staff reviews the inventory information and 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 (EVR) which identifies key data errors and warnings of possible reporting data errors. The errors are corrected, the warnings considered, and the EVR is run again to ensure the correction of all errors.
- Copies of the FNS-153 reports and all backup documentation are submitted to the 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 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."

Auditors' Comment:

We reported a similar finding in the 2014 audit. Please refer to finding 2014-008

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Reference Number:

2013-012

Federal Program:

14.239

State Administering Department:

California Department of Housing and Community Development (HCD)



**Audit Finding:** Subrecipient Monitoring. 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 Investments Partnership Program (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.

**Status of Corrective Action:** Fully Corrected.

HCD has updated its application, documents, and procedures for collection of awardee DUNS numbers and entry of awards in the Federal Funding Accountability Transparency Act (FFATA) Subaward Reporting System.

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**Reference Number:** 2013-013

**Federal Program:** 14.239

**State Administering Department:** California Department of Housing and Community Development (HCD)

**Audit Finding:** Reporting. Housing failed to timely report subawards greater than \$25,000 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.

**Status of Corrective Action:** Fully Corrected.

Procedures and processes have been fully implemented to increase controls thereby timely reporting subawards.

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**Reference Number:** 2013-014

**Federal Program:** 16.738  
16.803

**State Administering Department:** California Office of Emergency Services (CalOES)

**Audit Finding:** Subrecipient Monitoring. CalOES does not have adequate controls to issue management decisions on findings reported in subrecipient OMB Circular A-133 audit reports within six months after receipt of the audit report. Failure to issue management decisions in a timely manner may result in delays in recovery of questioned costs and corrective actions.

Status of Corrective Action: Fully Corrected.

CalOES has provided additional training to the monitoring staff on use of the database "alert" system to track Management Decision Letter due dates in order to ensure timely corrective action for noncompliance issues. CalOES has also implemented an additional query of the Federal Audit Clearinghouse 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.

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Reference Number: 2013-015

Federal Program: 16.738

State Administering Department: California Board of State and Community Corrections (BSCC)

Audit Finding: Subrecipient Monitoring. . BSCC does not have adequate policies and procedures to monitor its Justice Assistance Grant (JAG) program recipients in accordance with federal requirements. 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.

Status of Corrective Action: Partially Corrected.

BSCC is currently drafting a more comprehensive Policies and Procedures Manual for monitoring program recipients funded with state and federal funds. This includes developing and implementing a risk assessment mechanism for prioritizing monitoring when 100 percent on-site visits are unattainable or cost prohibitive. In addition, scheduled monitorings for the federal JAG projects have begun and are partially completed. A scheduled list of JAG projects being monitored by BSCC staff are included in a letter previously sent to KPMG, LLP. BSCC is also developing a fiscal desk review (remote) that will be implemented for those programs deemed financially low-risk and when an annual on-site visit is not calendarized.

Auditors Comment: The finding was not repeated in the 2014 audit as BSCC has taken sufficient action to address the finding.

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Reference Number: 2013-016

Federal Program: 17.258  
17.259  
17.278

State Administering Department: California Employment Development Department (EDD)

Audit Finding: Subrecipient Monitoring. EDD 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. Failure to issue management decisions in a timely manner may result in delays in recovery of questioned costs and proper corrective action.

Status of Corrective Action: Fully Corrected.

EDD continues to utilize on-line automated tools to track the status of the management decision and send automated alerts to keep the decision process on schedule. EDD has shortened the process timeline followed to review findings and make management decisions to comply with the six month requirement. Additionally, the status of each single audit requiring a management decision is a standing agenda item.

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Reference Number: 2013-017

State Administering Department: California Employment Development Department (EDD)

Federal Program: 17.258  
17.259  
17.278

Audit Finding: Subrecipient Monitoring. EDD did not properly obtain DUNS numbers from its subrecipients prior to awarding Workforce Investment Act (WIA) Cluster funds. Failure to obtain DUNS numbers prior to awarding funds increases the risk that EDD may not properly report subaward information to the federal government.

Status of Corrective Action: Fully Corrected.

EDD has resolved this finding by adding the request for DUNS number to the "Subgrantee EIN" form (Enclosure A) that the Workforce Services Branch sends out with the Workforce Investment Act Title 1 - Youth Subgrant Award packages. EDD requires subgrantees to return this form prior to funding.

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Reference Number: 2013-018

Federal Program: 17.258  
17.259  
17.278

State Administering Department: California Employment Development Department (EDD)

Audit Finding: Reporting. EDD should strengthen its policies and procedures over the FFATA reporting to ensure subaward information is reported in accordance with federal requirements.

Status of Corrective Action: Fully Corrected.

EDD published the FFATA Directive WSD 12-11 on January 18, 2013 (Enclosure B) which provided guidance to federally funded subawardees and subcontractors on FFATA reporting requirements. Entry of information has been kept current in FFATA to date.

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Reference Number: 2013-019

Federal Program: 17.225

State Administering Department: California Employment Development Department (EDD)

Audit Finding: Reporting, Special Tests and Provisions. EDD's information technology controls over logical access and change management for the Accounting and Compliance Enterprise System (ACES) were not properly designed or operating effectively. 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.

Status of Corrective Action: Fully Corrected.

EDD modified the Appointment/Separation Checklist (DE 7411) to include notifying proper group for user terminations. ACES was changed to automatically deactivate users upon 90 days of inactivity. EDD updated policy and procedures, as well as streamlined automated processing, to inactivate and remove Active Directory accounts for employees leaving the department. EDD also updated procedures and created a report that captures all code changes that are set to be migrated ensuring that these changes are brought to the ACES Change Control Board for approval prior to implementation. EDD requested the Solution Request Manager to prevent the ability for any employee to approve and migrate their own solution into production.

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Reference Number: 2013-020

Federal Program: 20.205 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Audit Finding: Special Tests and Provisions. Caltrans lacked adequate controls to ensure required materials certifications were prepared. The material 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.

Status of Corrective Action: Partially Corrected.

Caltrans developed and issued a new Construction Policy Directive on October 24, 2013, which was sent to all districts. In addition, the Caltrans Construction Manual was revised to include a detailed list of documents that are to be maintained indefinitely in a project history file. Caltrans will be updating the Construction Manual procedures that will be implemented on a uniform basis throughout the State. Caltrans anticipates full implementation by June 30, 2015.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-013.

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Reference Number: 2013-021

Federal Program: 20.205 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Audit Finding: Activities Allowed/Allowable Costs, Cash Management, Matching, and Reporting. Information technology controls over logical access and change management within the Caltrans Advantage Financial ERP system (Advantage) were not properly designed and operating effectively. 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.

Status of Corrective Action: Fully Corrected.

Caltrans agreed with KPMG's recommendation and immediately implemented the corrective actions.

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Reference Number: 2013-022

Federal Program: 20.319 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Audit Finding: Davis-Bacon Act. 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 the 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 non-compliance with Davis Bacon Act requirements.

Status of Corrective Action: Partially Corrected.

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. 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 requests, which will be followed by invoice payment approval by the supervisor. Caltrans is working with the Legal Division to revise the language to include Davis Bacon requirements where applicable. This language revision is on task to be completed by September 30, 2014.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-015.

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Reference Number: 2013-023

Federal Program: 20.319 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

Audit Finding: Suspension & Debarment, Special Tests and Provisions. 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 Excluded Parties List System (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 Schedule of Expenditures of Federal Awards (SEFA) and Data Collection Form (SF-SAC) presentation as required for American Recovery and Reinvestment Act of 2009 (ARRA)-funded awards. Failure to communicate SEFA and SF-SAC presentation increases the risk that ARRA requirements may not be followed by the subrecipients.

Status of Corrective Action: Fully Corrected.

Caltrans' Division of Rail, with assistance from Caltrans' Legal and Caltrans' Division of Procurement and Contracts, will include required language in the standard provisions for future subrecipient contract agreements. Additionally, staff will be trained to check the EPLS and to maintain supporting documents in the project history files.

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Reference Number: 2013-024

Federal Program: 20.319 (ARRA)

State Administering Department: California Department of Transportation (Caltrans)

**Audit Finding:** Reporting. Caltrans does not have adequate controls in place to ensure accuracy of Federal Financial Reports (SF-425) submitted for the High Speed Rail program. Further, Caltrans did not accurately report the federal share of expenditures for three of nine SF-425 reports tested, resulting in an understatement of federal expenditures. Failure to reconcile reports to supporting documents increases the risk of error in information reported to the federal government.

**Status of Corrective Action:** Partially Corrected.

Caltrans' Division of Rail has developed a tracking tool for grant managers that calculates the amounts to be reported on the SF-425, with validation and approval being performed by the grant manager's supervisor and the federal grants coordinator prior to submitting the reports to the Federal Railroad Administration, and has developed training to be provided to all employees on the use of this tool for SF-425 reporting. Additionally, the Federal Railroad Administration has provided further guidance on how to complete the SF-425 accurately.

**Auditors' Comment:** We reported a similar finding in the 2014 audit. Please refer to finding 2014-018.

**Reference Number:** 2013-025

**Federal Program:** 20.319 (ARRA)

**State Administering Department:** California Department of Transportation (Caltrans)

**Audit Finding:** Reporting. 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 Section 1512 reports resulting in an understatement of federal expenditures. Failure to reconcile reports to supporting documents increases the risk of errors in information reported to the federal government.

**Status of Corrective Action:** Fully Corrected

The Section 1512 reports are a quarterly requirement and the understatements identified have been corrected as of the January 30, 2014, reporting deadline. Congress repealed the recipient reporting for Recovery Act awards as of February 1, 2014.

**Reference Number:** 2013-026

**Federal Program:** 20.509

**State Administering Department:** California Department of Transportation (Caltrans)

**Audit Finding:** Subrecipient Monitoring. 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. 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.

**Status of Corrective Action:** Fully Corrected.

Caltrans has implemented a process to ensure it obtains and reviews single audit reports, as necessary, for all special districts for which it passes through federal funds. Caltrans has a process in place to follow-up with non-profits and universities subrecipients who expend more than \$500,000 in federal funds to ensure single audit reports are received and reviewed. In addition, Caltrans is including a follow-up of special districts.

**Auditors' Comment:** We reported a similar finding in the 2014 audit due to the fact that Caltrans was not in compliance during the full year. Please refer to finding 2014-022.

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**Reference Number:** 2013-027

**Federal Program:** 20.509

**State Administering Department:** California Department of Transportation (Caltrans)

**Audit Finding:** Reporting. Caltrans does not have proper controls in place to evidence its review of the SF-425 prior to submissions. In addition, Caltrans could not provide supporting amounts reported for some of the SF-425 reports. 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.

**Status of Corrective Action:** Partially Corrected.

Caltrans agreed 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 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 key staff to ensure that supporting documentation is retained.

**Auditors' Comment:** We reported a similar finding in the 2014 audit. Please refer to finding 2014-021.

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**Reference Number:** 2013-028

**Federal Program:** 20.509

**State Administering Department:** California Department of Transportation (Caltrans)



Audit Finding:

Cash Management. Caltrans does not have proper controls in place to evidence its review of cash draws prior to submission to the federal government. Failure to maintain adequate controls increases the risk that Caltrans may draw down inaccurate amounts of federal funds.

Status of Corrective Action:

Fully Corrected.

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 has reviewed procedures with involved staff and will ensure that the procedures are followed to retain supporting documentation in the future.

Reference Number:2013-029

Federal Program:10.553  
10.555  
10.556  
10.559  
10.565  
84.010  
84.011  
84.027  
84.173(ARRA)  
84.282  
84.377  
84.410  
93.575  
93.596

State Administering Department:

California Department of Education (Education)

Audit Finding:

Reporting. Education does not have an adequate process or control in place to ensure information required by the FFATA is properly reported for each of its federally funded programs. Education reported subaward information for the Career and Technical Education—Basic Grants to States program 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.

Status of Corrective Action:

Fully Corrected.

Education implemented a reporting schedule and processes that would ensure compliance with the requirements of the FFATA Subaward Reporting System.

Reference Number:2013-030

Federal Program:84.011

State Administering Department:	California Department of Education (Education)
Audit Finding:	<u>Reporting; Special Tests and Provisions.</u> 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 non-profit organization on behalf of Education. Education relies on the nonprofit organization to establish the system of quality controls required by federal regulations and ensure an accurate count of migrant students. As a result, Education may not report accurate information to the federal government.
Status of Corrective Action:	Partially Corrected.  In 2013-14, Education began implementation of the 2013-14 Migrant Education Office Plan for obtaining and verifying Statewide Student Identifiers (SSID). In January 2014, Education initiated the projected data match between California Longitudinal Pupil Achievement Data System (CALPADS) and MSIN. The data match was completed in June 2014. This match determined that 88 percent of students in kindergarten through twelfth grade had a valid SSID. The subsequent tasks, related to local SSID verification and non-match student reconciliation, have yet to be implemented as Education did not have staff resources to conduct the file match. In May 2014, the California Legislature approved migrant funding for an additional staff person to focus solely on the data quality items in the Migrant Education Program. Education plans to hire within 90 days.
Auditors' Comment:	The finding was not repeated in the 2014 audit as Education has taken sufficient action to address the finding.
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Reference Number:	2013-031
Federal Program:	84.048
State Administering Department:	California Community Colleges Chancellor's Office (CCCCO)
Audit Finding:	<u>Subrecipient Monitoring.</u> CCCCCO failed to perform site visits, desk reviews, or other monitoring procedures as specified in their risk-based monitoring plan. In addition, 6 of the 72 subrecipients of funds had Career and Technical Education (CTE) program findings included in their OMB Circular A-133 audit reports. CCCCCO did not issue management decisions within the required 6 months for these findings. Failure to properly monitor subrecipients increases the risk that federal funds may be spent for unallowable purposes.

## Status of Corrective Action:

Fully Corrected.

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. CCCCCO established and implemented a process to review the OMB Circular A-133 audits of community college districts as well as procedures to follow up with those districts to ensure that Carl D. Perkins related findings have been corrected.

## Reference Number:

2013-032

## Federal Program:

84.027

## State Administering Department:

California Department of Education (Education)

## Audit Finding:

Level of Effort-Maintenance of Effort. Education lacked adequate controls to ensure it met maintenance of effort (MOE) requirements and did not request a waiver from the U.S. 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.

## Status of Corrective Action:

Fully Corrected.

The condition reported by the auditors is based on preliminary apportionment figures. Education recalculated its state financial support (State MOE) for FY 2010-11 based on the final special education principal apportionment; the result was a State MOE failure of \$79,749,000. Education submitted an April Letter to address the shortfall; subsequently, the Legislature appropriated \$79,749,000 in general fund dollars to meet the special education MOE shortfall. This finding is now fully corrected.

## Auditors' Comment:

We do not believe the issue has been fully corrected and have issued finding number 2014-025.

## Reference Number:

2013-033

## Federal Program:

84.126

## State Administering Department:

California Department of Rehabilitation (Rehabilitation)

## Audit Finding:

Eligibility. As noted during the 2011-12 audit, Rehabilitation lacked adequate controls to determine applicant eligibility for services with the 60-day time period and to develop an Individualized Plan for Employment (IPE) within 90 days of eligibility determination. Rehabilitation continued to lack adequate controls and was not compliant with federal regulations.

Status of Corrective Action:

Partially Corrected.

The Vocational Rehabilitation Employment Division's Customer Service Unit (CSU) continues to monitor 60-day eligibility and 90-day IPE timelines. Recent monitoring reports reflect effective case monitoring practices complying with regulatory time frames.

The team manager (TM) trainings on how to generate Activity Reporting Environment (AWARE) reports to identify consumers who have eligibility determinations and IPEs due in the next 30-days is scheduled. The repeated training is scheduled mid to late 2015.

The district administrators (DA) and TMs review regulations and requisite form signatures with applicable staff during monthly management team meetings, and will continue this ongoing practice.

Rehabilitation strengthened controls for the periodic review of casework for rehabilitation counselors. TMs are required to conduct annual reviews of at least ten percent of the cases of a rehabilitation counselor with post-approval authority to ensure compliance with all applicable regulations. The TMs will document the review findings, and take appropriate action for non-compliance. A memorandum was issued to DAs outlining the new policy on July 31, 2014. The first annual District Record of Services Review summary reports are due to the CSU by June 30, 2015.

Rehabilitation developed draft policy guidance to be released in the Rehabilitation Administration Manual, Chapter 30 (RAM 30) on requisite documentation by Rehabilitation for cases where the application date on the DR 222 (Vocational Rehabilitation Services Application) does not match the application date in AWARE. Final review for release is expected no later than September 30, 2014. When RAM 30 is approved and issued, appropriate policy guidance will be provided to all field staff to provide consistency clarification.

Regulations and policies regarding requisite forms and necessary signatures are reviewed with the DAs and TMs with applicable staff during monthly management team meetings. Rehabilitation will continue this on-going practice.

Rehabilitation revised the AWARE Reference Guide to include instructions on requisite documentation for cases where the application date on the DR 222 does not match the application date in AWARE.

Auditors' Comment:

The finding was not repeated in the 2014 audit as Rehabilitation has taken sufficient action to address the finding.

Reference Number:

2013-034

Federal Program:

84.126

State Administering Department:

Department of Rehabilitation (Rehabilitation)

Audit Finding: Procurement. There was one incident where two Rehabilitation 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 Rehabilitation's policies and procedures and directly contracted with the vendor.

Status of Corrective Action: Fully Corrected.

This was an isolated incident in a field office identified by Rehabilitation in December 2012. Due to noncompliance with department policies and procedures, one of the two employees was terminated in July 2013.

Rehabilitation reviewed existing procedures and issued a Contracts and Procurement Bulletin regarding use of administrative service orders (2013-01) in June 2013. The Bulletin clarified the process. This requires all service orders, regardless of dollar amount, be pre-approved by the Central Office, Contracts and Procurement Section prior to funds being encumbered by the Accounting Section. This bulletin sufficiently clarifies the process.

Rehabilitation field office procurement staff attended the Department of General Services acquisition training in November 2013 and May 2014.

An overview on the use of service orders was provided at the statewide Central and Field Office Forum held in March 2013.

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Reference Number: 2013-035

Federal Program: 84.126

State Administering Department: Department of Rehabilitation (Rehabilitation)

Audit Finding: Activities Allowed/Allowable Costs. Rehabilitation does not have adequate controls in place to approve expenditures charged to the federal grant. Rehabilitation was unable to provide evidence of review of 6 of 25 central/internal service items tested and 1 of 25 indirect costs tested. Failure to review supporting documentation for expenditures increases the risk of federal funds spent on unallowed activities or costs.

Status of Corrective Action: Fully Corrected.

Rehabilitation reviewed internal procedures for approval of central/internal service and indirect cost items and strengthened its process by requiring evidence of approval be included on these invoices.

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Reference Number: 2013-036

Federal Program: 84.126

State Administering Department: Department of Rehabilitation (Rehabilitation)

Audit Finding: Level of Effort-Maintenance of Effort. Rehabilitation 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, Rehabilitation could be subject to a reduction of federal funding.

Status of Corrective Action: Remains Uncorrected.

Rehabilitation and the U.S. Department of Education's Rehabilitation Services Administration (USDoE/RSA) are engaged in discussions regarding the MOE waiver for federal fiscal year 2011. Final instruction from USDoE/RSA is pending.

Auditors' Comment: The finding was not repeated in the 2014 audit as we did not identify any noncompliance in the MOE calculation in the current year.

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Reference Number: 2013-037

Federal Program: 84.282

State Administering Department: California Department of Education (Education)

Audit Finding: Period of Availability. Education obligated federal funds totaling \$517,500 to one charter school outside 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.

Status of Corrective Action: Fully Corrected.

Education has contacted the U.S. Department of Education to confirm whether the finding is accurate or if a waiver is necessary. However, to strengthen internal controls over program funding, Education has revised the Request for Applications timelines to prevent funding from being obligated and disbursed outside the period of availability.

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Reference Number: 2013-038

Federal Program: 84.282

State Administering Department: California Department of Education (Education)

Audit Finding: Subrecipient Monitoring. 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. In one instance, a subrecipient report was not reviewed prior to disbursing its next apportionment. Failure to review the expenditure reports increases the risk that a subrecipient may spend federal funds on unallowed activities or costs.

Status of Corrective Action: Fully Corrected.

Education has implemented the Budget/Expenditure Approval Process and Budget/Expenditure Reporting Process as outlined in the Corrective Action Plan. Staff continues to integrate current and prospective subgrantees into these processes.

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Reference Number: 2013-039

Federal Program: 84.388 (ARRA)  
84.410

State Administering Department: California Department of Education (Education)

Audit Finding: Reporting. Education did not have adequate processes or controls in place to ensure accuracy of the quarterly Section 1512 reports prior to submission for the School Improvement Grant Cluster. These reports are maintained by program personnel but is not reconciled to the accounting records. The amount reported as disbursed to one local education 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.

Status of Corrective Action: Fully Corrected.

ARRA 1512 reporting requirement ended on January 31, 2014; however, the ARRA School Improvement Grant (SIG) program has a waiver that extends the use of ARRA SIG funds through September 30, 2014. Education submitted the final report to the federal government, which reconciles to Education's accounting records.

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Reference Number: 2013-040

Federal Program: 93.558  
93.658  
93.659

State Administering Department: Department of Social Services (Social Services)

Audit Finding: Reporting. During 2011-12, Social Services did not comply with reporting requirements of the FFATA for its federally funded programs. Social Services is in the process of implementing its FFATA reporting process, but failed to submit the 2012-13 FFATA reports.

Status of Corrective Action: Fully Corrected.

The corrective action plan has been fully implemented. Social Services has established an updated work plan and checklist tools to ensure timely updates and accurate reporting.

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Reference Number: 2013-041

Federal Program:	93.772 93.775 93.777 93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Audit Finding:	<u>Subrecipient Monitoring.</u> 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 federal Patient Protection and Affordable Care Act (PPACA). Through Covered California, the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) was deployed 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. Even with the changes to eligibility under the PPACA, the OMB Circular 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.
Status of Corrective Action:	Partially Corrected.  The quality control pilot programs referenced in the CAP are underway. Round 1 reviews have been performed, and Health Care Services will begin Round 2 reviews in September. In terms of the county budget methodology development, Health Care Services is currently in the process of procuring a contractor to assist with development of the methodology as required by Senate Bill 28.
Auditors' Comment:	We reported a similar finding in the 2014 audit. Please refer to finding 2014-028.
Reference Number:	2013-042
Federal Program:	93.767 93.772 93.775 93.777 93.778
State Administering Department:	Department of Health Care Services (Health Care Services)
Audit Finding:	<u>Activities Allowed/Allowable Costs.</u> Health Care Services obtained a Service Organization Control (SOC1) report over logical security, change management, backup and restoration, and production job processing functions of California Medicaid Management Information System (CA-MMIS) for the period of 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.



Status of Corrective Action:	<p>Partially Corrected.</p> <p>Timely and accurate documentation is essential to the security and confidentiality of CA-MMIS. Evidence that documentation creation, reviews, and updates are not taking place, and the lack of adequate procedures to ensure required documentation is created, reviewed, and updated at least annually are of the greatest concern to Health Care Services.</p> <p>At least annually, the contract between Health Care Services and its contractor requires reviews and/or updates for all CA-MMIS documentation listed in the Contract, Exhibit A, Attachment II, Sections HH-QQ including, but not limited to, Manuals, Deliverables, Plans, Policies, and Procedures.</p> <p>As a result of this finding, Health Care Services has instructed its contractor, Xerox, to:</p> <ul style="list-style-type: none"><li>• Create documentation listed in the Master Manual List (MML) and the Configurable Items List.</li><li>• Create and maintain policy documentation to assure proper processing of jobs.</li><li>• Create documented instructions for handling processing deviations such as abnormal jobs.</li><li>• Prioritize and bring current all reviews or updates for all CA-MMIS documentation listed in Exhibit A, Attachment II, Sections HH-QQ including but not limited to Manuals, Deliverables, Plans, Policies, and Procedures.</li><li>• Document the plan and procedures for keeping contractual documents updated as required.</li><li>• Add all CA-MMIS documentation to the Configurable Items List.</li></ul> <p>Health Care Services is following up with Xerox to confirm the delivery date of expected items. Health Care Services will reaffirm the need for a formal extension of time should Xerox not meet the established deadlines.</p>
Auditors' Comment:	<p>We reported a similar finding in the 2014 audit. Please refer to finding 2014-030.</p>
Reference Number:	<p>2013-043</p>
Federal Program:	<p>93.767 93.772 93.775 93.777 93.778</p>
State Administering Department:	<p>Department of Health Care Services (Health Care Services)</p>

**Audit Finding:** Activities Allowed/Allowable Costs. Health Care Services utilizes the Medi-Cal Managed Care Monthly Capitation (CAPMAN) system to adjudicate managed care provider monthly payments based on the number of beneficiaries enrolled during the period. Certain program access controls were not operating effectively during 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.

**Status of Corrective Action:** Fully Corrected.

Health Care Services created and followed a new process titled "Annual review of system access to CAPMAN". 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. Health Care Services documented the process in a document titled "820/834 Production Support, Roles and Responsibilities". The next review will be in October 2014.

Health Care Services created a new form for managers to formally request access additions, removals, and changes. The form documents the requested level/type of access and is stored for future retrieval and documentation purposes.

This new process was completed in September 2013 and is still currently being used.

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**Reference Number:** 2013-044

**Federal Program:** 93.772  
93.775  
93.777  
93.778

**State Administering Department:** Department of Health Care Services (Health Care Services)

**Audit Finding:** Eligibility; Subrecipient Monitoring. Counties do not have adequate controls to ensure eligibility determinations and redeterminations were appropriate and timely.

**Status of Corrective Action:** Remains Uncorrected.

Health Care Services is expecting to reissue guidance to counties in September 2014 as stated in the corrective action plan.

**Auditors' Comment:** The finding was not repeated in the 2014 audit as Health Care Services has taken sufficient action to address the finding.

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**Reference Number:** 2013-045

**Federal Program:** 93.772  
93.775  
93.777  
93.778

State Administering Department: Department of Health Care Services (Health Care Services)

Audit Finding: Subrecipient Monitoring. Health Care Services continues to lack adequate policies and procedures to monitor subrecipients. Health Care Services does not have policies and procedures in place to ensure that DUNS numbers are obtained from its subrecipients prior to awarding federal funds. Health Care Services also does not perform planned site visits but rather performs desk reviews due to travel restrictions; however, it was identified that 9 of 28 local agencies or local education consortiums did not have a site visit or desk review performed within the past three years. Further, 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.

Status of Corrective Action: Partially Corrected.

Health Care Services was able to perform seven of the nine county site visits and/or desk reviews for Sonoma, Orange, Fresno, Riverside, San Diego, San Luis Obispo, and City of Pasadena. Health Care Services will complete the remaining site visits and/or desk reviews for Santa Cruz and Solano by June 30, 2015.

Health Care Services added contract language in Exhibit B, Budget Detail and Payment Provision Section, to require Local Governmental Agencies (LGAs) and Local Educational Consortiums to submit the appropriate documentation to Health Care Services indicating their DUNS number prior to final execution of the contract agreement. Health Care Services issued a Policy and Procedure Letter 13-014 dated December 10, 2013 notifying LGAs of the OMB Circular A-133 Single Audit Report requirement for all subrecipients reporting federal funds of more than \$500,000.

Auditors' Comment: We reported a similar finding in the 2014 audit. Please refer to finding 2014-032.

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Reference Number: 2013-046

Federal Program: 93.917

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

Audit Finding: Cash Management. Public Health does not have proper controls in place to ensure that rebate income is disbursed prior to requesting reimbursement from the federal government. Failure to utilize rebate income may result in inaccurate or untimely drawdowns of federal funds.

Status of Corrective Action: Fully Corrected.

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Public Health agrees it 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 Public Health'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, the 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 AIDS Drug Assistance Program (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, the 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 to \$3 million, OA uses federal ADAP funds. On January 23, 2014, OA issued a memo to the AIDS Drug Assistance Program Branch's fiscal staff documenting the new procedure.

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Reference Number:	2013-047
Federal Program:	93.917
State Administering Department:	Department of Public Health (Public Health)
Audit Finding:	<u>Subrecipient Monitoring.</u> 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.
Status of Corrective Action:	Partially Corrected.
	This audit recommendation has not been fully implemented because no contracts were amended for 2014-15. However, Public Health's Office of AIDS (OOA) does identify the CFDA number in Exhibit A, "Scope of Work", as specified in the Public Health Contract Management Unit's CFDA bulletin. Because no contracts will be amended for 2014-15, OOA will send out a Management Memorandum to all contractors by March 31, 2015 to provide them with the CFDA and title number.
Auditors' Comment:	We reported a similar finding in the 2014 audit. Please refer to finding 2014-033.

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Reference Number:	2013-048
Federal Program:	93.958
State Administering Department:	Department of Health Care Services (Health Care Services)
Audit Finding:	<u>Subrecipient Monitoring; Special Tests and Provisions.</u> 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. Specifically, Health Care Services failed to obtain DUNS numbers from subrecipients prior to awarding federal funds, and also failed to properly monitor subrecipients through site visits, limited scope audits or other means. Lack of peer reviews and subrecipient monitoring increases the risk that federal monies will be paid for unallowable costs and that programs may not meet quality, appropriateness, and efficacy for treatment services standards of the state.
Status of Corrective Action:	Fully Corrected  Health Care Services has updated its policies and procedures for subrecipient monitoring of its Mental Health program. Health Care Services conducts three site reviews per fiscal year. Peer reviews have been integrated with site reviews..  Three Mental Health site reviews were performed in 2013-14. Sacramento County's site review was conducted on April 29, 2014. On May 30, 2014, a site review of Placer County was performed and a site review of San Joaquin County convened on June 30, 2014.

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Reference Number:	2013-049
Federal Program:	93.959
State Administering Department:	Department of Health Care Services (Health Care Services)
Audit Finding:	<u>Allowable Costs.</u> 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).
Status of Corrective Action:	Fully Corrected.  Since July 1, 2013, Health Care Services has had a full fiscal year to assimilate the former ADP processes into Health Care Services' processes. During this time, Health Care Services has implemented policies and procedures in compliance with the State Administrative Manual, generally accepted accounting principles, and Code of Federal Regulations, Title 41 over record retention as it relates to former ADP transactions.

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Reference Number:	2013-050
Federal Program:	93.959
State Administering Department:	Department of Health Care Services (Health Care Services)
Audit Finding:	<u>Cash Management</u> . ADP did not have adequate policies and procedures to ensure federal draw requests are reconciled to amounts recorded by SCO.
Status of Corrective Action:	Fully Corrected.

Since July 1, 2013, Health Care Services has had a full fiscal year to assimilate the former ADP processes into Health Care Services' processes. During this time, Health Care Services has implemented policies and procedures in compliance with State Administrative Manual, generally accepted accounting principles, and Code of Federal Regulations, Title 41 for Federal Draw requests and reconciliation to SCO records of the former ADP transactions.

## **Response to the Audit - Department of Finance**



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

March 20, 2015

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, 2014. This report was the result of your examination of the state's administration of federal programs for the fiscal year ended June 30, 2014, 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 6 qualified opinions for the 26 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 more complex and vast than most economic entities in the world. Moreover, these 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 state is committed to sound and effective fiscal oversight.

Individual departments have separately responded to the Single Audit Report findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. The combined results of the fiscal year 2013-14 Single Audit will be disseminated to all departments and Finance will remind departments of their responsibility for implementing corrective action plans. Further, we will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

The Financial Integrity and State Manager's Accountability Act (FISMA) specifies 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.



KPMG LLP  
March 20, 2015  
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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. 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.

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

Sincerely,



MICHAEL COHEN  
Director



Department of Finance  
915 L Street  
Sacramento, CA 95814  
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