Notes to the Financial Statements

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The accompanying financial statements present the financial position and the results of operations of the State for the year ended June 30, 2000. These statements have been prepared in compliance with state laws, state accounting procedures, and the state budget.

The State of California also prepares a separate report, the *Comprehensive Annual Financial Report*, which includes financial statements prepared in conformity with generally accepted accounting principles (GAAP). A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P. O. Box 942850, Sacramento, California 94250-5876.

The State of California *Budgetary/Legal Basis Annual Report* presents information on those financial activities of the State over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. The financial statements in this report include accounts of various boards, commissions, agencies, authorities, retirement systems, and the State's public universities. The funds from which these entities operate are included in this report in accordance with Government Code Section 12461(c), which requires the *Budgetary/Legal Basis Annual Report* to include statements showing the receipts, disbursements, and closing balances of each fund in the State Treasury.

The University of California, including its various branches, is administered by a Board of Regents as a public trust. It is subject only to such legislative control as may be necessary to insure compliance with the terms of the endowments of the University and the security of its funds. The financial transactions of the University of California are included in this report only as to the amounts appropriated by the Legislature for support and capital outlay. Expenditures from these appropriations are included as part of the cost of state government.

The financial transactions of district agricultural associations, citrus fairs, and county fairs are included only with regard to the disbursement of state funds appropriated for their use. These associations and fairs are semi-independent and operate with both state and local funds.

B. Fund Accounting

The diverse nature of governmental operations and the need for complying with legal provisions requires that the accounts of the State be organized on the basis of funds rather than the single set of accounts commonly used by commercial enterprises.

Each fund is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts comprised of its assets, liabilities, fund equity, revenues, and expenditures, or expenses as appropriate.

These funds of the State are divided into two main groups: Governmental Cost Funds and Nongovernmental Cost Funds.

Governmental Cost Funds consist of those funds that receive revenues derived from taxes, licenses, and fees. Expenditures of these funds represent the cost of government. There are two major fund classifications in this group: the General Fund and Special Funds. The purpose of each fund classification is described below:

The *General Fund* is the main operating fund of the State consisting of moneys that are not required by law to be deposited in any other fund.

Special Funds are used to account for resources that are legally restricted for particular functions or activities of government. The following are classified as special funds:

- *General Fund Special Accounts* are legislatively created accounts within the General Fund to account for revenues that are restricted by law for specific purposes. The accounts are treated as special funds and are excluded from the General Fund for accounting and budgetary purposes.

- *Feeder Funds* are the depositories for the collection of major taxes prior to clearance to the General Fund. The resources and obligations of these funds that apply to the General Fund as of June 30 are included in Due from Other Funds. Resources and obligations remaining in any of these funds represent collections that were not available to the General Fund on June 30.

- *Transportation Funds* are used to account for revenues that are restricted by law to transportation and related public safety programs.

- *Other Governmental Cost Funds* are used to account for other revenues that are restricted by law for specific purposes.

Nongovernmental Cost Funds consist of those funds that derive their revenue from sources other than general and special taxes, licenses, fees, or other state revenues. Expenditures of these funds do not represent a cost of government. There are three major fund classifications under this group: Bond Funds, Trust and Agency Funds–Federal, and Other Nongovernmental Cost Funds. The purpose of each fund classification is described below:

Bond Funds are used to record proceeds from the sale of general obligation bonds and the expenditure for acquisition of property, capital outlay, or loans to local agencies for the same purposes.

Trust and Agency Funds–Federal are used to account for moneys that are received from the federal government to be expended for specific purposes.

Other Nongovernmental Cost Funds are used to account for the following revenues and services:

- *Public Service Enterprise Funds* are used to account for the transactions of state-operated enterprises that render services primarily to the public for a charge.
- *Working Capital and Revolving Funds* are used to account for the internal service activities rendered by a state agency for other state agencies or local governments.
- *Retirement Funds* are used to account for contributions received by various retirement systems, the investment of these moneys, retirement allowances, and refunds to members.
- *Trust and Agency Funds–Other* are used to account for moneys and properties that are received and disbursed by the State as trustee or custodian.

C. Measurement Focus and Basis of Accounting

Governmental cost funds are presented using the flow of current financial resources measurement focus. With this measurement focus, operating statements present increases and decreases in net current assets.

The accounts of the governmental cost funds are reported using the modified accrual basis of accounting. Revenues of the governmental cost funds are recognized according to the provisions of Government Code Sections 13302-13303. Revenues are accrued if the underlying transaction has occurred as of the last day of the fiscal year and the due date for the tax is within two months of the end of the fiscal year. Receivables for which collection is indefinite are fully reserved until collected or determined to be uncollectible.

Expenditures of governmental cost funds include obligations incurred but not paid by June 30. This includes all interfund settlements due but not completed at the end of the fiscal year. Encumbrances (such as obligations in the form of purchase orders, contracts, or salary commitments chargeable to an appropriation) at year end are excluded from the liabilities and expenditures and are established as a reserve for encumbrances against the fund balance. Transfers from governmental cost funds to nongovernmental cost funds are shown as expenditures of the governmental cost funds in the fiscal year covered by this report even though actual expenditures from the nongovernmental cost funds may not occur until a later date (e.g., transfers to the Architecture Revolving Fund for capital outlay purposes).

The measurement focus for the nongovernmental cost funds varies among fund types. Proprietary fund types and pension trust funds are presented using the flow of economic resources measurement focus; the other fund types are presented using the flow of current financial resources measurement focus.

The basis of accounting for the nongovernmental cost funds also varies among fund types. The accounts of the proprietary fund types and pension trust funds are reported using the accrual basis of accounting. Under the accrual basis, revenues are recognized when they are earned, and expenses are recognized when they are incurred. The accounts of the other fund types are reported using the modified accrual basis of accounting.

D. Fixed Assets

Fixed assets are only reported for nongovernmental cost funds. They are reported at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. Interest during construction has not been capitalized. Also, public domain or "infrastructure" fixed assets are not capitalized.

General fixed assets for governmental cost funds are reported as expenditures at cost in the year purchased.

E. Long-Term Obligations

The State Constitution permits the State to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. Proceeds from the sale of general obligation bonds, including premium and accrued interest, are recorded in the Bond Funds. The debt service for general obligation bonds is appropriated from the General Fund. Premium and accrued interest received when bonds are sold is transferred to the General Fund to reimburse the debt service. 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. Self-liquidating bonds reimburse the General Fund for the debt service provided on their behalf.

F. Fund Equity

The term *fund balance* is defined as the excess of the assets of a fund over its liabilities. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balance that are legally segregated for specific uses.

Contributed Capital represents the amount of capital contributed to proprietary funds, including permanent working capital advanced by other funds that are not required to be repaid.

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

Reserved for Employees' Pension Benefits represents reserves of the retirement funds. These reserves include accumulated contributions made by employees and employers, and undistributed interest and investment earnings.

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

Reserved for Deposits represents the balance of trust and agency funds outside the state treasury that account for money or property held by state agencies not required to be deposited in a fund in the state treasury.

Reserved for School Loans represents the amount of outstanding school loans authorized by Chapter 703, Statutes of 1992, and Chapter 66, Statutes of 1993, and deferred to be repaid from future General Fund appropriations. These loans are to be treated as General Fund expenditures in the year the appropriations are legislated.

Other Reserves represent the amounts reserved for other specific purposes.

The *Special Fund for Economic Uncertainties* (the "rainy day fund") provides the moneys for those necessary expenditures throughout the year that have not been anticipated or provided for in the annual budget. It also provides relief, to the amount of its available funds, for any budgeted shortfalls. The balance of this special fund at year end is added to the balance of the General Fund, as required by the Government Code, to show the total moneys available for General Fund purposes. As of June 30, 2000, the balance of the Special Fund for Economic Uncertainties was $3.8 billion. Included in this amount is $3.0 billion transferred from the General Fund Unreserved-Undesignated fund balance, in accordance with Government Code Section 16418(e).

The *Contingency Reserve for Economic Uncertainties* represents the unappropriated balance in each special fund as of June 30, which is available for appropriation in the following fiscal year.

The *Unreserved-Undesignated* represents the net of total fund balance less reserves. A negative unreserved-undesignated balance must be funded before any amount is available for appropriation.

The balances of all appropriations for which the availability for encumbrance and expenditure expired before or at the end of the fiscal year covered by this report are included in the fund equity.

G. Pooled Money Investment Account Loans

Cash temporarily idle during the year was invested in the Pooled Money Investment Account (PMIA). The investment of the PMIA is restricted by law to certain categories, including loans to various bond funds. Outstanding loans to the various bond funds as of June 30 are reflected as PMIA Loans Payable in the bond funds and as PMIA Loans Receivable in each fund group in the Combined Balance Sheet of this report. PMIA Loans Receivable is not reflected in the individual fund statements of this report since the loans were made directly from the PMIA, and the specific funds providing the loans are not identifiable.

H. Comparative Statements

This report includes the Comparative Statement of Actual and Estimated Revenues and the Comparative Statement of Actual and Budgeted Expenditures for the year ended June 30, 2000. The Comparative Statement of Actual and Estimated Revenues provides a comparison of the actual governmental cost fund revenues earned with the estimated revenues reflected in Schedule 8, Comparative Statement of Revenues, of the 2000–01 Governor's Budget Summary. The Comparative Statement of Actual and Budgeted Expenditures provides a comparison of the actual governmental cost fund expenditures incurred with the total appropriations for the 1999–2000 fiscal year.

I. Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIIIB of the California Constitution. Article XIIIB established a limit on the growth of certain appropriations made from state tax revenues, adjusted annually for inflation and population growth. All tax revenue received was to have been appropriated within the limit or returned to the taxpayers. Proposition 98 and 99, both of which were approved by voters in the November 1988 general election, and Proposition 111, which was approved by voters in the June 1990 general election, amended Article XIIIB.

Proposition 98 required that tax revenues received in excess of the state appropriations limit be allocated to school districts and community colleges (K-14) rather than returned to the taxpayers. The amount to be allocated is not to exceed 4% of the minimum school funding level. Effective in fiscal year 1988-89, Proposition 98 provides a guaranteed minimum level of funding for school districts and community colleges. The K-14 programs are guaranteed either the same percentage of General Fund revenues appropriated in fiscal year 1986-87 or the state and local tax revenues received in the prior year adjusted for changes in the cost of living and enrollment, whichever is greater.

Proposition 99, the Cigarette Tax Initiative, placed an additional tax on cigarette purchases in California. Before the enactment of Proposition 99, an additional tax would have been considered revenue subject to the appropriations limit. This initiative specified that these additional tax revenues are not subject to the appropriations limit and dedicated the revenue for specific purposes.

Proposition 111 provided that tax revenues received in excess of the state appropriations limit in one fiscal year may be carried over to the succeeding fiscal year. The portion of the excess revenues carried over that cannot be appropriated in the succeeding fiscal year would be considered excess revenues. Fifty percent of all excess revenues must be allocated to school districts and community colleges, and the other 50% must be returned to the taxpayers. Prior to the enactment of Proposition 111, the maximum amount to be allocated to school districts and community colleges was 4% of the minimum school funding level. Proposition 111 also excludes from the State's appropriations limit appropriations for costs of natural disasters, appropriations of all qualified capital outlay projects, and appropriations of revenue derived from increases in motor vehicle fuel taxes, sales and use taxes on the increased motor vehicle fuel taxes, and weight fees.

Article XIIIB imposed no limit on appropriations or funds obtained through nontax sources such as from reasonable user charges or fees and bond proceeds. The state appropriations limit is also exclusive of certain appropriations such as debt service on voter-approved debt, debt existing when Article XIIIB was adopted, and state subventions to local governments that are not restricted in their use. State appropriations to local governments are considered tax proceeds for local entities, and are subject to each local entity's revenue and appropriations limit.

The appropriations limit is established each year in the Budget Act and is amended during the fiscal year for transfers of fiscal responsibility between the State and the local governments. The Budget Act provides that any judicial action or proceeding to attack, review, set aside, void, or annul the revenue and appropriations limit must begin within 45 days of the effective date of the act. There have never been any such judicial actions or proceedings.

NOTE 2 BUDGETARY AND LEGAL COMPLIANCE

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

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

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

Two legislative bills were not passed by August 31, 2000, the last day of the legislative session, that were intended to increase the appropriation authority of previously enacted legislation. Departments with deficiency funding requests in these bills, totaling approximately $808 million, have paid and will pay the claims related to past year deficiencies by using the following methods: (1) California Medical Assistance Program claims have been paid as required by the federal Medicaid Act, Title 42, United States Code section 1396a(a)(37), which states that the State plan for medical assistance must — "provide for claims payment procedures which (A) ensure that 90 per centum of claims for payment (for which no further written information or substantiation is required in order to make payment) made for services covered under the plan and furnished by health care practitioners through individual or group practices or through shared health facilities are paid within 30 days of the date of receipt of such claims and that 99 per centum of such claims are paid within 90 days of the date of receipt of such claim..." (2) Payroll deficiencies have been paid as required by the federal Fair Labor Standards Act, Title 29, United States Code section 206(b), which states, in part, that "Every employer shall pay each of his employees...not less than the minimum wage in effect..." (3) Departments will wait to receive an allocation from the new deficiency bill, which the legislative leadership has committed to passing when the new session resumes, prior to making any payments. (4) Departments with immediate funding needs of approximately $142 million have been authorized by the Department of Finance to either increase, or establish, Office Revolving Funds in sufficient amounts to pay claims related to the deficiencies included in the deficiency bills. In all cases, valid amounts related to these deficiencies are included as expenditures in this report.

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

Legislative appropriations are based on when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year goods and services are received.

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

Financial activities are mainly controlled at the appropriation level but can vary depending on the presentation and wording contained in the Budget Act. Certain items that are established at the category, program, component, or element levels can be adjusted by the Department of Finance. While the financial activities are controlled at various levels, the legal level of budgetary control has been established in the Budget Act at the appropriation level for the annual operating budget.

NOTE 3 LONG-TERM OBLIGATIONS

A. Capital Appreciation Bonds

The State issued capital appreciation bonds in the amount of $17 million with a delivery date of April 1, 1993. The bonds were issued in denominations of principal amounts per $1,000 value, payable in full at maturity. Unlike all other bonds issued by the State, these bonds are not subject to redemption prior to their stated maturities, and no current interest payments will be made prior to maturity. In the General Obligation Bonds, Interest and Redemption statement, the accreted value is included in the "Bonds Outstanding" column and the "Issued" column. The accreted value represents the portion of the face value of the bonds that reflects principal and interest accrued to date. For June 30, the accreted value will be interpolated on a straight-line basis between the accreted value for the immediately preceding April 1 and the next succeeding October 1 as displayed in the official bond statement. As of June 30, 2000, the accumulated interest of the bonds outstanding was $8.3 million.

B. Defeased Bonds

The State has defeased certain bonds by placing the proceeds of new bonds in irrevocable escrow in a special trust account with the State Treasury to provide for all future debt service payments on the old bonds. Accordingly, the assets of the trust accounts and the liability for the defeased bonds are not included in the State's financial statements. As of June 30, 2000, approximately $1.6 billion of general obligation bonds outstanding are considered defeased.

C. Commercial Paper Notes

The general obligation commercial paper program was established pursuant to Chapter 697, Statutes of 1995. Under this program, the State issues general obligation commercial paper notes which may be renewed or may be refunded by the issuance of general obligation bonds. Commercial paper notes are deemed issued upon authorization by the respective finance committees.

D. Settled Litigation

On November 8, 1988, voters of the State approved Proposition 98, a constitutional amendment called the "Classroom Instructional Improvement and Accountability Act." Moneys appropriated for Proposition 98 are primarily dependent upon the state appropriations limit. Appropriations for Proposition 98 can only be expended for educational purposes and cannot be reappropriated for any other purpose. Therefore, expenditures are recognized for all Proposition 98 appropriations in the fiscal year of the appropriation.

During the recent California recession, General Fund revenues were less than originally projected. The Legislature responded to these developments both in September 1992 and June 1993, by authorizing up to $1.8 billion in school loans to be repaid from future year General Fund appropriations.

Later in 1992, *California Teachers Association v. Gould* was filed. This lawsuit challenged the validity of these school loans. As part of the settlement agreement, which was reached on July 23, 1996, both parties, K-14 schools and the State, agreed to the joint responsibility for payments. Table 1 discloses the remaining liability for these payments.

Table 1

Proposition 98 Loan Repayment Schedule
(Amounts in millions)

Fiscal Year	Total Loans Paid	K-14 Schools	State
2000-2001	350	125	225
2001-2002	350	125	225
Total	**700**	**250**	**450**