



KATHLEEN CONNELL
Controller of the State of California

December 16, 1999

**To the Citizens, Governor, and Members
of the Legislature of the State of California:**

I am pleased to submit the State of California's *Comprehensive Annual Financial Report* (CAFR) for the year ended June 30, 1999. This report contains all the information needed to fully assess California's fiscal condition.

As California's Chief Financial Officer, I am extremely gratified by our state's stellar economic performance and robust growth this year as we stand on the cusp of a new millennium. Evidence of this strong, diverse economy is manifest. Unemployment is at record lows, while residential real estate, home construction, and consumer spending achieved record highs this year. Capital gains and personal income for California residents increased dramatically in 1999.

California's economy became far more diversified during the last ten years, as the state adjusted to meet the challenges of a changing society. It has become more resilient, broad based, and differentiated north to south. High tech industry has expanded, filling declines in the manufacturing and defense-oriented industries. California businesses are now stronger than ever, and can compete more effectively in both the domestic and world markets.

Despite these glowing indicators, there are critical issues that could threaten the state's economy and continued good fortune. One major threat is the decades-long imbalance between state and local financing. The current system has too often resulted in the neglect and deterioration of the critical public services — parks, streets and roads, and libraries, for example — that local communities provide. If California is to remain prosperous in the 21st century, we must encourage balanced land use planning, increase discretionary income for local government, and distribute revenues equitably statewide, proportionate to the public need in all communities.

In February of this year, I assembled a task force of distinguished experts — the State Municipal Advisory Reform Team, or SMART task force — to assess the current system of local government financing. I then challenged them to craft an innovative blueprint for the equitable distribution of revenues to local governments. Their resultant SMART plan recommends capping the diversion of property tax revenues and apportioning future local sales taxes on a per capita rather than point-of-sale basis. It also requires the State to fund new programs or services that it mandates local governments to provide, and advocates tools for improving the efficiency and effectiveness of local governments. I believe the SMART plan addresses and resolves many of the critical challenges local governments currently face.

Creativity and innovation must also be our touchstones as we educate and train tomorrow's workforce in the high tech skills they will need to drive the state's growth and leadership into the future. With 5.7 million K-12 students, California educates more youthful minds than any other state in the nation. Unfortunately, we are not earning A's in this endeavor. Average test scores show California's students performing below the national average in the critical core subjects of math, science, and reading. California's per pupil spending remains below the national average. We cannot hope to keep the California dream alive if we do not take dramatic and aggressive steps to improve the quality of the education that our children — tomorrow's leaders — receive.

California's changing demographics will also significantly impact the state's economy and the demand for public services into the 21st century. The state's population is increasing dramatically. In just the last four years, the population has grown by 1.4 million — including an influx of twice as many immigrants as any other state in the nation. The Baby Boom generation, now producing high tax revenues in their prime earning years, will eventually shift from revenue generators to a dependent population as they begin to age and retire. These and other factors will create increased burdens on housing, education, transportation, and health care services.

Providing equitable access to health care for all citizens is one of the most significant challenges we face in the next decade. Many sectors of our society, both working and retired, are either uninsured or underinsured, creating a society of "haves" and "have nots" in relation to health care benefits. Tens of thousands of our state's retired teachers, for instance, do not receive health benefits. As a member of the board of the California State Teachers' Retirement System and as Chair of the Health Benefits Task Force, I assembled the Health Executive Advisory Review Team, or HEART, to explore methods for providing a comprehensive health care delivery system for teachers in California. But we can't stop there — the health of the state is inextricably connected to the health of all of its citizens.

This report commemorates the 150th anniversary of the State Controller's Office. When California's constitution was signed in 1849, none of the new State's leaders could have foreseen the technological advances that would be created during the 20th century, nor the new industries born of these inventions. In the last 90 years, we have seen the advent of the automobile and construction of the state and inter-state freeway systems that transformed the state's commerce, land use, and economy. During just the last 20 years, the personal computer, the Internet, and high tech industries have completely changed the face of modern business on a global basis.

We are now on the threshold of a new era, one whose technologies and innovations are as imperceptible to us as these inventions were to Gold Rush-era leaders. As we prepare to meet the unknown challenges and opportunities that await us in the coming millennium, we must continue to encourage and embrace creativity and innovation. We must use California's "New Economy" as a wellspring to support and enhance the systems that foster the health, wellbeing, and quality of life of California's citizens into the 21st century.

Economic Outlook

As we venture into a new calendar year and millennium, the strength of the California economy has not subsided. The performance of most economic sectors over the past five years has been nearly spectacular. Growth of employment, resident spending, and personal income continues to remain solid in 1999. Non-farm employment growth will increase 2.9%, taxable sales will rise 8%, and personal income will record an impressive 6.5% increase in 1999.

Both residential and non-residential building activity this year will exceed all other years of the 1990s. The residential real estate market is especially strong, setting new records for existing home sales in the state. Commercial vacancies are at or near their lows for the decade in San Francisco, Alameda, Santa Clara, and Los Angeles counties, and more new commercial building than at any other time during the last 10 years is currently underway.

Consumer spending has been prolific in 1999. Single family home sales jumped 9% to all-time record levels in California. Higher incomes, accumulated wealth from the stock market, and historically low interest rates were the principal reasons for another strong year in residential real estate.

Home building hit a new high for the decade in 1999. New residential units will reach 142,000 this year, an 18% increase over last year's total. While the continued gain is encouraging, this level of new home building remains very lean as housing is generally in short supply across the state, and accordingly expensive. The median selling price of homes in California jumped 8% to \$217,000, the highest value on record. With rising interest rates, the outlook for the housing market weakens in 2000, but lack of available inventory combined with population growth will prevent selling prices from retreating.

The unemployment rate fell to 4.6% in October of 1999, the lowest rate in 30 years. More residents of California are currently employed than at any other time in the history of the state. Nearly 400,000 jobs will be created in California this year, principally in the business services, education, social services, and recreation sectors. Despite the economic weakness in the Pacific Rim countries that has reduced our overall exports 4.2% in 1999, employment levels have improved 5.5% at the ports, due to increased import activity.

Double-digit equity market returns during the 1998-99 fiscal year resulted in large capital gains income for California residents. Income from all assets, including financial assets, will grow by over 6% in 1999. Personal income tax receipts, the largest single source of revenue to the California General Fund, jumped 10.8% for the year ending June 30, 1999. Overall, General Fund revenues advanced a healthy 7.6% for the fiscal year.

The state's economy has been especially strong because many of its premier industries principally serve a national and global market. No one industry dominates, even among the manufacturing sectors, which typically are the most vulnerable to recession abroad. Ten years ago, a major part of the economy was concentrated in research and manufacturing for aerospace. As that industry suddenly downsized, the state was left vulnerable. That kind of vulnerability is absent today. Biotechnology, semi-conductors, information processing, recreation, entertainment, tourism, apparel manufacturing, and construction all contribute to a very diverse and strong California economy.

Major Initiatives for the Year

The 1998-99 fiscal year continued the trend of the past four years in which tax revenues to the General Fund exceeded levels that were anticipated when the budgets were enacted. The additional revenues totaled roughly \$1.0 billion in 1998-99. Given the higher revenues, the 1998-99 budget contained a large increase in funding for K-14 education as mandated by Proposition 98 and for new program incentives.

Significant elements of the 1998-99 budget included:

- Tax cuts totaling \$1.4 billion were enacted. One bill provided for a phased-in reduction of the Vehicle License Fee (VLF). Starting on January 1, 1999, the VLF was reduced by 25%, at a cost to the General Fund of approximately \$500 million in the 1998-99 fiscal year and about \$1.0 billion annually thereafter. In addition, the 1998-99 Budget included both temporary and permanent increases in the personal income tax dependent credit, a nonrefundable renters' tax credit, and various targeted business tax credits.
- Proposition 98 funding for K-14 schools was increased by \$1.7 billion in General Fund moneys over revised 1997-98 levels — over \$300 million higher than the minimum Proposition 98 guarantee. Major new programs included funding for instructional and library materials, deferred maintenance, support for increasing the school year to 180 days, and reduction of ninth grade class size.
- Funding for higher education increased substantially above 1997-98 levels. General Fund support was increased by \$340 million (15.6%) for the University of California and \$267 million (14.1%) for the California State University system. In addition, community colleges funding increased by \$300 million (6.6%).
- The budget included increased funding for health, welfare, and social services programs. A 4.9% increase was included in the basic welfare grants, the first increase in those grants in nine years.
- Funding for the judiciary and criminal justice programs increased by about 11% over 1997-98, primarily in increased state support for local trial courts and rising prison populations.

Financial Information

Reporting Entity: The financial reporting entity of the State includes all the funds and account groups of the primary government as well as all of its component units. Component units are legally separate entities for which the primary government is financially accountable. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Accordingly, the building authorities are reported within the capital projects funds of the primary government. The lease agreements, amounting to \$784 million between the building authorities and the primary government, have been eliminated from the combined balance sheet. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the appropriate account groups. Discretely

presented component units are reported in separate columns in the combining financial statements to emphasize that they are legally separate from the primary government and to differentiate their financial position, results of operations, and cash flows from those of the primary government. The University of California and special purpose authorities are reported as discretely presented component units.

Budgetary Controls: Annually, the State Legislature prepares a budget that contains estimates of revenues and expenditures for the ensuing fiscal year. This budget is the result of negotiations between the Governor and State Legislature. Throughout the fiscal year, adjustments in the form of budget revisions, executive orders, and financial legislation agreed to by the parties are made to the budget. The Controller is statutorily responsible for maintaining control over revenues due the primary government and the expenditure of each appropriation contained in the budget. Budgeted appropriations are the expenditure authorizations that allow state agencies to purchase or create liabilities for goods and services.

The accounting system provides the Controller's Office with a centralized control record system to fully account for each budgeted appropriation, including its unexpended balance, and for all cash receipts and disbursements. The accounting system is decentralized in that the detail of each control account is maintained at the agency level. During the fiscal year, the control accounts and agency accounts are maintained and reconciled on a cash basis. At the end of the fiscal year, each agency prepares annual accrual reports for receivables and payables. The Controller's Office combines its control accounts with the agency accrual reports to prepare the *Budgetary/Legal Basis Annual Report* and the *Budgetary/Legal Basis Annual Report Supplement*. The methods of accounting for expenditures and revenues in these reports are governed by state laws and regulations that, in some cases, are not in full agreement with generally accepted accounting principles. The information in the *Comprehensive Annual Financial Report* presents a consolidation of the amounts in the *Budgetary/Legal Basis Annual Report* and adjustments to the account balances to conform to generally accepted accounting principles.

Internal Controls: An internal control structure has been designed to ensure that the assets of the government are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management. In addition, the government maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature.

General Government Functions: The government provides a full range of services including education, health and social services, transportation, law, justice, public safety, recreation, resource development, and public improvements. These general government functions are accounted for in the General Fund, special revenue funds, and capital projects funds.

Chart 1

REVENUES 1998-99
General, Special Revenue, and
Capital Projects Funds

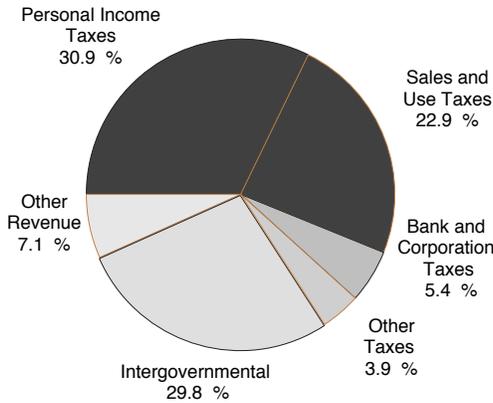
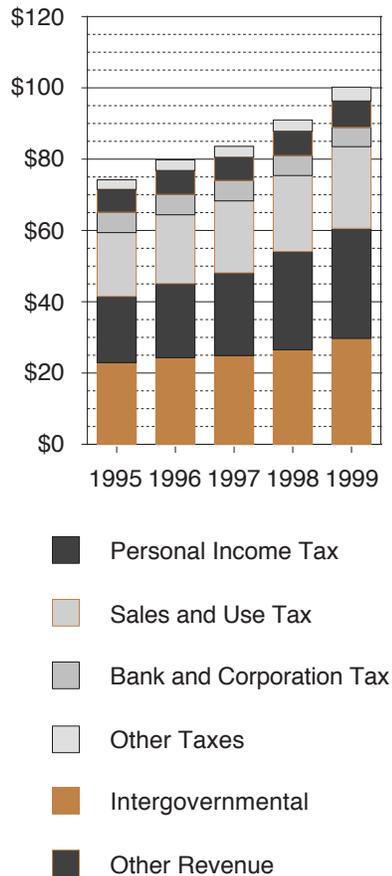


Chart 2

REVENUES by SOURCE
General, Special Revenue, and
Capital Projects Funds
 (Amounts in billions)



1998-99 Revenues: Table 1 presents a summary of General Fund, special revenue funds, and capital projects funds revenues for the year ended June 30, 1999. Revenues for the General Fund, special revenue funds, and capital projects funds totaled \$99.9 billion for the year ended June 30, 1999. This was an increase of \$8.5 billion, or 9.5%, over the previous year. Tax revenues increased \$5.0 billion, or 8.7%, over the previous year. Personal income, sales and use, and other taxes increased \$3.0 billion, \$1.6 billion, and \$645 million, or 10.8%, 7.4%, and 19.8%, respectively. Bank and corporation taxes decreased \$180 million, or 3.2%. Intergovernmental revenue increased \$3.2 billion, or 11.9%.

Five-Year Trend: Total revenues for the General Fund, special revenue funds, and capital projects funds have increased from \$74.2 billion in 1995 to \$99.9 billion in 1999, an increase of \$25.6 billion, or 34.5%. This increasing revenue trend is the result of a rebounding California economy that is generating increased collections of taxes. Personal income taxes have increased from \$18.6 billion in 1995 to \$30.9 billion in 1999, an increase of \$12.3 billion, or 66.2%. Sales and use taxes have increased from \$17.9 billion in 1995 to \$22.9 billion in 1999, an increase of \$5.0 billion, or 27.6%. Total

Table 1

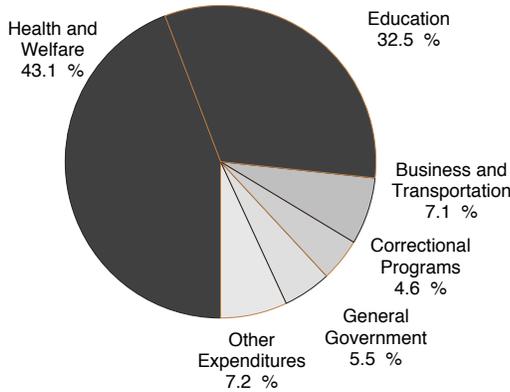
Schedule of General Fund, Special Revenue Funds, and Capital Projects Funds Revenues

Year Ended June 30, 1999 (Amounts in thousands)

Sources	1998-99 Amount	Percent of Total	Increase (Decrease) from 1997-98	Percent of Increase (Decrease)
Taxes				
Personal income.....	\$ 30,862,872	30.9 %	\$ 3,004,253	10.8 %
Sales and use.....	22,878,316	22.9	1,573,532	7.4
Bank and corporation.....	5,421,742	5.4	(179,784)	(3.2)
Other taxes.....	3,899,802	3.9	645,161	19.8
Intergovernmental.....	29,667,982	29.8	3,164,298	11.9
Other revenue				
Licenses and permits.....	3,334,863	3.3	146,468	4.6
Fees and penalties.....	1,857,098	1.9	(115,525)	(5.9)
Charges for services.....	812,336	0.8	205,183	33.8
Investment and interest....	692,738	0.7	92,126	15.3
Other minor.....	407,089	0.4	36,894	10.0
Natural resources.....	15,950	0.0	(23,754)	(59.8)
Total.....	\$ 99,850,788	100.0 %	\$ 8,548,852	9.4

Chart 3

EXPENDITURES 1998-99
General, Special Revenue, and
Capital Projects Funds

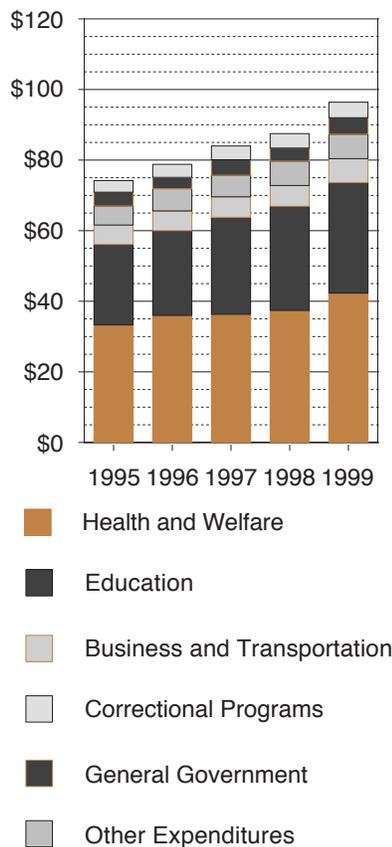


revenues for the five-year period increased \$770 million, \$5.7 billion, \$5.0 billion, \$6.4 billion, and \$8.5 billion in the years ending June 30, 1995, 1996, 1997, 1998, and 1999, respectively.

1998-99 Expenditures: Table 2 presents a summary of General Fund, special revenue funds, and capital projects funds expenditures for the year ended June 30, 1999. Expenditures for the General Fund, special revenue funds, and capital projects funds totaled \$95.5 billion for the year ended June 30, 1999. This was an increase of \$7.8 billion, or 8.9%, over the previous year. Changes in expenditures by function from the previous year's levels are presented in Table 2. Health and welfare expenditures increased \$3.9 billion, or 10.3%. This increase relates to changes in the CalWorks program, increases in the supplementary security income state supplemental payments (SSI/SSP) and in-home/supportive service programs. General government expenditures increased by \$1.2 billion, or 30.6% — mainly due to replacement payments to local governments for the decrease in VLF, and increased funding to the trial courts.

Chart 4

EXPENDITURES by FUNCTION
General, Special Revenue, and
Capital Projects Funds
 (Amounts in billions)



Five-Year Trend: Total expenditures for the General Fund, special revenue funds, and capital projects funds

Table 2

Schedule of General Fund, Special Revenue Funds, and Capital Projects Funds Expenditures

Year Ended June 30, 1999 (Amounts in thousands)

Function	1998-99 Amount	Percent of Total	Increase (Decrease) from 1997-98	Percent of Increase (Decrease)
Health and welfare.....	\$ 41,197,842	43.1 %	\$ 3,863,965	10.3 %
Education.....	31,048,022	32.5	1,546,763	5.2
Business and transportation.....	6,752,759	7.1	799,427	13.4
Correctional programs.....	4,382,129	4.6	289,927	7.1
General government.....	5,256,688	5.5	1,230,577	30.6
Other expenditures				
Debt service.....	2,170,146	2.3	66,670	3.2
Resources.....	2,351,796	2.5	376,135	19.0
State and consumer services.....	797,127	0.8	49,916	6.7
Property tax relief.....	599,004	0.6	(18,316)	(3.0)
Capital outlay.....	939,749	1.0	(421,039)	(30.9)
Total.....	\$ 95,495,262	100.0 %	\$ 7,784,025	8.9

Chart 5

GENERAL OBLIGATION BONDS by FUNCTION
(Amounts in billions)

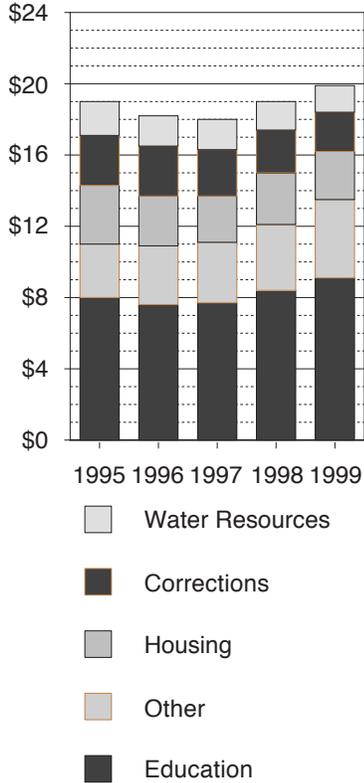
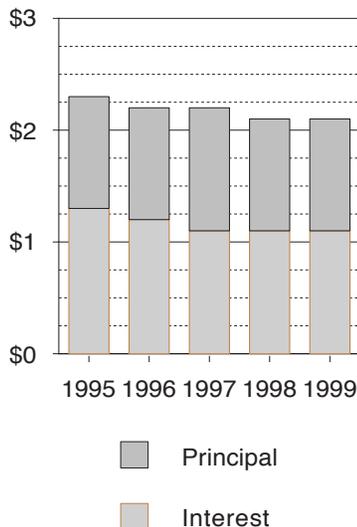


Chart 6

DEBT SERVICE EXPENDITURES
(Amounts in billions)



have increased from \$74.2 billion in 1995 to \$95.5 billion in 1999, an increase of \$21.2 billion, or 28.7%. During this period, expenditures have increased 23.6% for health and welfare, 36.4% for education, 22.8% for business and transportation, and 33.2% for corrections. In aggregate, expenditures for the five-year period increased \$1.4 billion, \$4.6 billion, \$7.2 billion, \$1.7 billion, and \$7.8 billion in the years ending June 30, 1995, 1996, 1997, 1998, and 1999, respectively.

Debt Administration: On July 30, 1996, Standard and Poor’s Rating Group raised its bond rating for California from “A” to “A+.” In October 1997, Fitch Investors Services raised its rating from “A+” to “AA+.” Moody’s Investors Service raised its rating from “A1” to “Aa3” in October 1998.

General Obligation Bonds: General obligation bonded debt, which is backed by the full faith and credit of the General Fund, increased from \$18.9 billion on June 30, 1998, to \$19.9 billion on June 30, 1999. This change reflected an increase of \$972 million, or 5.1%.

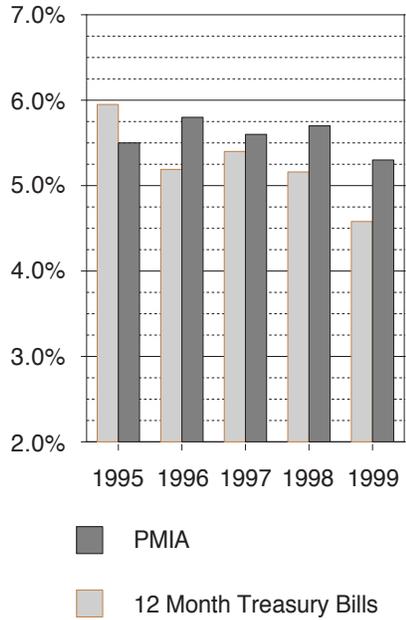
Five-Year Trend: Total outstanding general obligation bonds increased from \$19.1 billion in 1995 to \$19.9 billion in 1999, an increase of \$806 million, or 4.2%. During this period, education bonded debt increased from \$8.0 billion in 1995 to \$9.1 billion in 1999, an increase of \$1.1 billion, or 13.8%. Also during this period, bonded debt for water resources, corrections, and housing decreased from \$8.1 billion in 1995 to \$6.4 billion in 1999, a decrease of \$1.7 billion, or 21.1%. In aggregate, general obligation bonds for the five-year period increased (decreased) \$679 million, \$(871) million, \$(252) million, \$957 million, and \$972 million in the years ending June 30, 1995, 1996, 1997, 1998, and 1999, respectively.

Debt Service: Principal retirement expenditures for the General Fund, special revenue funds, and capital projects funds totaled \$1.0 billion for the year ended June 30, 1999. This change reflected an increase of \$44 million, or 4.4%, over the previous year. Interest and fiscal charges for these funds totaled \$1.1 billion for the year ended June 30, 1999. This was an increase of \$22 million, or 2.0%.

Five-Year Trend: General Fund, special revenue funds, and capital projects funds principal retirement expenditures increased from \$954 million in 1995 to approximately \$1.0 billion in 1999, an increase of \$92 million, or 9.7%.

Chart 7

**PMIA YIELD and AVERAGE
TREASURY YIELD
Year Ended June 30**



Interest and fiscal charges decreased from \$1.3 billion in 1995 to approximately \$1.1 billion in 1999, a decrease of \$179 million, or 13.8%.

Cash Management Policies and Practices: 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 the following categories: U.S. Government securities, securities of federally sponsored agencies, domestic corporate bonds, bank notes, interest-bearing time deposits in California banks and savings and loan associations, prime commercial paper, repurchase and reverse repurchase agreements, security loans, bankers' acceptances, negotiable certificates of deposit, and loans to various bond funds. The average daily investment balance for the year ended June 30, 1999, amounted to \$33.5 billion, with an average effective yield of 5.34%. For the year ended June 30, 1998, the average daily investment was \$29.3 billion and the average effective yield was 5.7%.

Five-Year Trend: PMIA yield decreased from 5.5% in 1995 to 5.3% in 1999. During this same time, the average yield on 12-month Treasury Bills decreased from 5.95% to 4.57%. The average daily investment portfolio has also increased from \$26.8 billion in 1995 to \$33.5 billion in 1999, an increase of \$6.6 billion, or 24.8%.

The total earnings of the PMIA for the year ended June 30, 1999, amounted to \$1.8 billion. Of this amount,

Table 3

Pooled Money Investment Account Portfolio

Year Ended June 30, 1999 (Amounts in thousands)

Type of Security	Average Daily Portfolio	Percent of Portfolio	Annual Earnings	Average Effective Yield
Money market.....	\$ 14,649,164	43.8 %	\$ 774,448	5.3 %
Government securities.....	13,184,865	39.4	707,932	5.4
Corporate bonds.....	2,215,515	6.6	124,789	5.6
Loans to other funds.....	2,143,780	6.4	117,878	5.5
Repurchase agreements.....	10,800	0.0	597	5.5
Time deposits.....	1,928,600	5.8	93,095	4.8
Reverse repurchase agreements.....	(681,634)	(2.0)	(30,974)	4.5
Total Portfolio.....	\$ 33,451,090	100.0 %	\$ 1,787,765	5.3

\$309 million was distributed to the General Fund, \$733 million to special funds, \$753 million to local governments, \$2 million to the Public Employees' Retirement System, and \$1.8 million to the State Teachers Retirement System. The Pooled Money Investment Account Portfolio is shown in Table 3.

General Fund Balance: The General Fund ended the year with a budgetary fund balance of \$3.9 billion and a fund balance of \$2.3 billion, using generally accepted accounting principles. The budgetary fund balance includes \$2.3 billion in reserves. The reserves represent that portion of the fund balance that is not available for appropriation or that is legally set aside for specific uses.

The Special Fund for Economic Uncertainties, the "rainy day fund," had a balance of \$1.6 billion at the end of the year. Annually, an amount is appropriated in the General Fund to replenish the fund. This fund, as the name implies, provides the monies 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 revenue shortfalls.

Proprietary Operations: Proprietary fund types present financial data on activities that are similar to those found in the private sector. Users are charged for the goods or services provided.

Enterprise funds account for goods or services provided to the general public on a continuing basis when the cost involved is to be financed or recovered primarily by user charges. Enterprise funds earned approximately \$4.3 billion in operating revenues and had \$3.3 billion in operating expenses for the year ended June 30, 1999.

Internal service funds account for activities that provide goods and services to other state departments or agencies on a cost reimbursement basis. Internal service funds earned approximately \$2.4 billion in operating revenues and had \$2.4 billion in operating expenses for the year ended June 30, 1999.

Fiduciary Operations: Fiduciary fund types are used to account for assets held by the primary government as a trustee or agent. Four fiduciary fund types are reported: expendable trust funds, which account for assets held in a trustee capacity when both principal and income (earnings on principal) may be expended in the course of a fund's designated operations; pension trust funds, which account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems; agency funds, which account for assets held by the primary government and where the primary government acts as an agent for individuals, private organizations, other governments, or other funds; and the investment trust fund, which accounts for deposits, withdrawals, and earnings of the Local Agency Investment Fund, an external investment pool for local governments and public agencies. Expendable trust funds earned approximately \$7.3 billion in revenues and had \$6.7 billion in expenditures for the fiscal year ended June 30, 1999. Pension funds had \$36.0 billion in additions and \$8.6 billion in deductions to the net assets available for plan benefits. The investment trust fund had net assets of \$14.2 billion as of June 30, 1999. Agency funds had assets of \$17.1 billion as of June 30, 1999.

Risk Management: The primary government has elected, with a few exceptions, to be self-insured against loss or liability and generally does not maintain reserves. Losses are covered by appropriations in the year in which the payment occurs, with workers' compensation benefits for self-insured agencies being initially paid by the State Compensation Insurance Fund (SCIF). The discounted liability for unpaid self-insured worker's compensation losses is estimated to be \$990 million as of June 30, 1999. Of this amount, \$130 million is being reported in the General Fund, \$79 million in special revenue funds, \$16 million in proprietary funds, and \$765 million in the General Long-Term Obligations Account Group.

Independent Audit: State statutes require an annual audit of the general purpose financial statements of the State. To meet this requirement, the State Auditor has examined the accompanying financial statements in accordance with government auditing standards issued by the Comptroller General of the United States and generally accepted auditing standards. The auditor's report on the general purpose financial statements and combining and individual fund statements and schedules is included in this report.

The State of California is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984, the Single Audit Act Amendments of 1997, and the U.S. Office of Management and Budget's Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Generally accepted auditing standards and the standards set forth in the General Accounting Office's Governmental Auditing Standards were used by the auditors in conducting the engagement. Information related to this single audit, including a schedule of federal financial assistance, the independent auditor's report on internal controls and compliance with applicable laws and regulations, and a schedule of findings and questioned costs are included in a separately issued single audit report.

Certificate of Achievement: The Government Finance Officers Association of the United States and Canada (GFOA) awarded the Certificate of Achievement for Excellence in Financial Reporting to the State of California for its *Comprehensive Annual Financial Report* for the year ended June 30, 1998. This is the third consecutive year the State has received this award. To earn this award, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. The report must satisfy generally accepted accounting principles and applicable legal requirements.

The Certificate of Achievement is valid for only one year. It is the view of the State Controller's Office that this year's report continues to conform to the Certificate of Achievement Program requirements, and it is being submitted to GFOA for its review. The State Controller's Office is committed to ensuring that the *Comprehensive Annual Financial Report* will continue to conform to the Certificate of Achievement Program requirements in the future.

This CAFR is prepared in accordance with nationally recognized standards. It is presented in three sections: Introductory, Financial, and Statistical. The Introductory Section includes this letter of transmittal. The letter presents a summary of financial data that is useful in evaluating the fiscal condition of the State. The Financial Section includes the general purpose financial statements and notes to the financial statements. The Financial Section also includes the combining fund and account group financial statements and schedules, which are presented for the purpose of additional analysis. The Statistical Section includes selected financial and demographic information, generally presented on a multi-year basis.

Responsibility for the accuracy of data, and the completeness and fairness of the presentation, including all disclosures, rests with the State. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner that fairly presents the financial position and operation of the various funds, account groups, and component units of the State.

This CAFR could not have been prepared without the generous assistance and cooperation of all state agencies. We wish to thank the State Auditor and his staff for their audit of the financial statements contained in this report. Also, I am grateful to my staff for their hard work and professionalism.

Sincerely,



KATHLEEN CONNELL
California State Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1998

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Cary Brubaker
President

Jeffrey L. Esser
Executive Director

Principal Officials of the State of California

Executive Branch

Gray Davis
Governor

Cruz Bustamante
Lieutenant Governor

Kathleen Connell
State Controller

Bill Lockyer
Attorney General

Philip Angelides
State Treasurer

Bill Jones
Secretary of State

Delaine Eastin
Superintendent of Public Instruction

Chuck Quackenbush
Insurance Commissioner

Board of Equalization

Johan Klehs, Member, First District
Dean F. Andal, Member, Second District
Claude Parrish, Member, Third District
John Chiang, Acting Member, Fourth District

Legislative Branch

John Burton
President pro Tempore, Senate

Antonio Villaraigosa
Speaker of the Assembly

Judicial Branch

Ronald M. George
Chief Justice, State Supreme Court

Organization Chart of the State of California

