Single Audit Report

2000-01

Gray Davis, Governor
State of California

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DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

GRAY DAVIS, GOVERNOR
STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

March 28, 2002

Ms. Janet Rehnquist, Inspector General
Department of Health and Human Services
Room 5250, Cohen Building
330 Independence Avenue, S.W.
Washington, D.C. 20201

Dear Ms. Rehnquist:

As the Governor's fiscal representative, I submit to you the State of California Single Audit Report for the fiscal year ended June 30, 2001. 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 federal assistance. The Independent Auditor identified reportable conditions related to internal control over financial reporting, instances of noncompliance applicable to major federal programs, and reportable conditions involving the internal control over compliance with major federal program requirements. However, the cumulative reportable internal control weaknesses and instances of noncompliance were not considered material and do not adversely affect the State's general purpose financial statements or compliance with major federal program requirements.

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

The head of each State department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. Each State department with reportable internal control weaknesses or instances of noncompliance is responsible for developing and implementing corrective action plans. The Department of Finance will continue to provide leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal controls exist for the safeguarding and effective use of assets and resources.

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

Sincerely,

B. TIMOTHY GAGE
Director

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Overview of California's Economy in Fiscal Year 2000-01

The national economy slipped into recession in March 2001, ending the longest economic expansion in our nation's history. The national and California economies slowed as a result of declining capital spending, a cooling stock market, struggling foreign economies, and the September 11 terrorist attacks. But unlike the recession of the early 1990s, California's economy showed considerable resilience during the downturn, continuing to outpace the nation in job growth throughout much of 2001.

California's Resilient Economy

California's economic performance in 2000 was arguably its best in over two decades. Despite a softening national economy, a high tech stock market shakeout, and emerging energy troubles, the state's economy put up impressive numbers. The state posted near-record job growth; unemployment fell sharply; and personal income surged at the fastest pace since the mid-1980s.

California's unemployment dipped to its lowest level in three decades during 2000. While its unemployment rate was higher than the national rate, the California job market was generally stronger than the nation's because of its superior job growth, youthful population, growing workforce, and its attractiveness to international immigrants.

California industry wage and salary employment grew by nearly 500,000 jobs in 2000, the second largest gain going back to 1940. The 496,200 net gain amounted to a 3.8 percent year-over-year growth rate. Service industries were again California's leading source of job growth, adding 226,000 jobs for an impressive 5.1 percent gain. Manufacturing employment increased by 24,700 jobs, recouping nearly 90 percent of the losses incurred in 1999. Jobs in transportation, communications, and utilities industries grew by 24,200, or 3.4 percent. Construction had the highest percentage job growth: 6.8 percent.

In the first half of 2001, one out of every four new jobs in the nation was created in California. High technology electronics and aerospace industries accounted for nearly half of California's durable goods manufacturing jobs. Despite the dramatic decline in venture capital investments and falling stock values, computer related service employment continued to grow.

California-made exports virtually exploded in 2000; expanding by nearly 21 percent overall. This gain was led by exports to Mexico, Japan, and South Korea. The four high technology industry groups—machinery (including computers), electrical and electronic equipment, transportation equipment, and instruments—-accounted for three quarters of all California exports, and high technology exports accounted for over 80 percent of California's export growth.

Through a variety of factors, including a lack of investment in new generation capacity and the failure of federal regulators to police the market, the electricity market broke down, leading to a dramatic run up in spot market prices. The Administration acted quickly to secure a reliable supply of power through encouraging conservation, expanding generation capacity, and putting pressure on the Federal Energy Regulatory Commission to implement price caps.

Even though prices in California accelerated somewhat, strong income growth produced another year of significant purchasing power gains for Californians. In 2000, real personal income, adjusted by the California consumer price index, increased over 7 percent. This marks the seventh consecutive year of accelerating income and real income growth.

California's Economic Challenge

California faces some challenges. By the fall of 2001, signs of an economic downturn were pronounced. The impact on the economy was magnified by the extraordinary rise and fall of the stock market—particularly in the high-technology sector—and the resulting sharp drop of income tax revenues coming from capital gains and stock options.

The volatility of stock market related income is the most significant financial factor influencing California's budget in 2002-03. In recent years, the stock market and in particular, the technology driven NASDAQ index, soared to unprecedented levels, awarding investors and employees with huge profits. The resulting capital gains and stock option income created a surge in State tax revenues. But in 2001, the reverse happened: the steep decline in the stock market cut deeply into stock market-related revenues. The impact of September 11 produced additional tax revenues losses. The sudden reversal resulted in a budget shortfall of $3 billion in the current year. This problem, combined with a reduced estimate of capital gains and stock market income and the need for a reserve, meant that the State had to close a funding gap exceeding $12 billion by June 30, 2002.

As the magnitude of the current fiscal challenge facing the State became more evident, the Administration took steps to reduce spending by administratively "freezing" approximately $2.2 billion in General Fund expenditures and transmitting its *Proposed Reduction in 2001-02 Spending* plan to the Legislature in November 2001. Essential programs providing core services were protected from significant reductions, including K-12 education, public safety, and health coverage for children and low-income families, as were those programs that provide an immediate stimulus to the state's economy.

Undoubtedly, the State continues to face energy challenges as a result of the recent bankruptcy filing on the part of Enron and credit rating downgrades for other suppliers. The Administration will continue to address the State's energy concerns through a multifaceted approach. In addition to bringing more power plants on line, California has embarked on a massive conservation effort, committed resources to increase California's total renewable energy production from today's 12 percent to 17 percent by 2006, and provided incentives to energy customers to reduce their consumption.

While the September 11 terrorist attacks dealt a blow to California tourism, the industry has bounced back somewhat but is still operating below prior levels. Improved confidence in public safety should boost the state's tourism industry.

Monetary and fiscal policy and earlier inventory paring will buoy the California economy in the first half of 2002. As with the rest of the nation, the main risks to the outlook are a sharp retrenchment by consumers and a deepening and extension of the high-tech recession. With its significant high-tech sector, California is more at risk to the latter than the nation. Tentative signs of a turnaround in the economy began appearing early in the year.

Part I

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State of California:

Financial Report
Year Ended June 30, 2001

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

Independent Auditors' Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the accompanying general purpose financial statements of the State of California, as of and for the year ended June 30, 2001, as listed in the table of contents. These general purpose financial statements are the responsibility of the State of California's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of certain capital projects funds, which reflect total assets and revenues, constituting 59 percent and 66 percent, respectively, of the capital projects funds. In addition, we did not audit the financial statements of certain enterprise funds, including those of the California State University, which reflect total assets and revenues, constituting 94 percent and 95 percent, respectively, of the enterprise funds. We did not audit the financial statements of certain internal service funds, which reflect total assets and revenues, constituting 22 percent and 44 percent, respectively, of the internal service funds. We also did not audit the financial statements of the pension trust funds, which reflect total assets constituting 85 percent of the fiduciary funds. Finally, we did not audit the University of California funds or the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 95 percent and 93 percent, respectively, of the component unit authorities. The financial statements of certain capital projects, enterprise and internal service funds, the pension trust funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

As discussed in Note 22 to the financial statements, the primary government is involved in certain lawsuits and regulatory proceedings relating to the Department of Water Resources entering into contracts and arrangements for the purchase and sale of electric power. These lawsuits could impact the timing of the sale of the bonds described in Notes 4, 22, and 25; the revenue requirements and rate structure needed to repay the debt payable; and the terms and conditions of the power purchase contracts. Because of the early stage of the legal and regulatory proceedings, the ultimate outcome of these matters cannot be presently determined.

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of California, as of June 30, 2001, and the results of its operations and the cash flows of its proprietary funds and component unit authorities for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The combining financial statements and schedules and required supplementary information listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of California. The information for the combining financial statements and schedules and the Schedule of Funding Progress in the required supplementary information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based upon our audit and the reports of other auditors, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

We did not audit the data included in the introductory and statistical sections of this report, and accordingly, we express no opinion on them. In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

November 16, 2001

General Purpose Financial Statements

Combined Balance Sheet

All Fund Types, Account Groups, and Discretely Presented Component Units

June 30, 2001
(amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
ASSETS AND OTHER DEBITS					
Cash and pooled investments	$ 3,830,104	$ 10,997,162	$ 179,872	$ 7,090,413	$ 472,042
Investments	—	—	5,694	3,971,272	96,276
Amount on deposit with U. S. Treasury	—	—	—	—	—
Receivables (net)	195,058	581,192	966	1,792,656	7,180
Due from other funds	12,854,223	3,650,940	60,062	305,928	338,150
Due from primary government	—	—	—	—	—
Due from component units	—	—	—	—	—
Due from other governments	514,414	6,885,089	—	117,127	14,684
Prepaid items	—	—	—	3,773	43,454
Food stamps	—	347,506	—	—	—
Inventories, at cost	—	—	—	17,371	95,807
Net investment in direct financing leases	—	—	—	4,793,991	—
Advances to other funds	44,649	4,201	—	19,877	—
Loans receivable	111,321	1,916,692	—	3,128,807	—
Recoverable power costs (net)	—	—	—	6,127,000	—
Deferred charges	—	—	—	1,093,668	—
Fixed assets	—	—	—	5,093,262	537,893
Investment in UCSF Stanford Health Care	—	—	—	—	—
Other assets	892	15,932	2	17,148	9,557
Amount to be provided for retirement of long-term obligations	—	—	—	—	—
Total Assets and Other Debits	**$ 17,550,661**	**$ 24,398,714**	**$ 246,596**	**$ 33,572,293**	**$ 1,615,043**

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

Fiduciary Fund Type	Account Groups		Total Primary	Component Units		Total Reporting
Trust and Agency	General Fixed Assets	General Long-Term Obligations	Government (Memorandum Only)	University of California	Special Purpose Authorities	Entity (Memorandum Only)
$ 26,574,293	$ —	$ —	**$ 49,143,886**	$ 152,046	$ 1,492,726	**$ 50,788,658**
295,782,854	—	—	**299,856,096**	70,681,490	8,857,016	**379,394,602**
6,412,589	—	—	**6,412,589**	—	—	**6,412,589**
13,067,856	—	—	**15,644,908**	2,049,218	465,392	**18,159,518**
6,368,579	—	—	**23,577,882**	—	—	**23,577,882**
—	—	—	**—**	222,792	17,740	**240,532**
—	—	—	**—**	135,157	—	**135,157**
1,497,398	—	—	**9,028,712**	190,430	808	**9,219,950**
9,780	—	—	**57,007**	—	1,723	**58,730**
—	—	—	**347,506**	—	—	**347,506**
—	—	—	**113,178**	113,413	—	**226,591**
—	—	—	**4,793,991**	—	—	**4,793,991**
617,208	—	—	**685,935**	—	2,500	**688,435**
631,036	—	—	**5,787,856**	—	6,715,320	**12,503,176**
—	—	—	**6,127,000**	—	—	**6,127,000**
—	—	—	**1,093,668**	83,403	62,820	**1,239,891**
—	18,159,778	—	**23,790,933**	18,205,528	549,349	**42,545,810**
—	—	—	**—**	6,843	—	**6,843**
240,535	—	—	**284,066**	—	85,167	**369,233**
—	—	28,829,007	**28,829,007**	—	—	**28,829,007**
$ 351,202,128	**$ 18,159,778**	**$ 28,829,007**	**$ 475,574,220**	**$ 91,840,320**	**$ 18,250,561**	**$ 585,665,101**

(continued)

Combined Balance Sheet

All Fund Types, Account Groups, and Discretely Presented Component Units (continued)

June 30, 2001
(amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
LIABILITIES					
Accounts payable	$ 2,067,042	$ 2,312,252	$ 3,598	$ 1,751,392	$ 170,933
Due to other funds	2,584,372	5,912,351	10,513	582,882	260,384
Due to component units	121,371	98,786	—	—	—
Due to other governments	4,196,733	2,223,658	47	151,746	103,871
Dividends payable	—	—	—	—	—
Deferred revenue	—	348,432	—	—	—
Advances from other funds	617,208	13,585	—	6,171,500	24,078
Tax overpayments	—	9,319	—	—	—
Benefits payable	—	—	—	794,174	69,427
Deposits	5	13,688	—	3,615	2,036
Contracts and notes payable	—	—	—	4,687	32,599
Lottery prizes and annuities	—	—	—	2,844,874	—
Compensated absences payable	143,460	—	—	33,724	38,698
Certificates of participation, commercial paper, and other borrowings	—	—	—	4,371,100	—
Capital lease obligations	—	—	—	—	66,948
Advance collections	33,630	100,049	3,509	378,891	212,660
General obligation bonds payable	—	—	—	3,358,270	—
Revenue bonds payable	—	—	—	8,802,888	—
Interest payable	4,369	—	7,525	148,503	1,391
Securities lending obligation	—	—	—	—	—
Other liabilities	204,156	191,652	—	450,255	26,440
Total Liabilities	**9,972,346**	**11,223,772**	**25,192**	**29,848,501**	**1,009,465**
FUND EQUITY AND OTHER CREDITS					
Contributed capital	—	—	—	296,484	347,083
Investment in general fixed assets	—	—	—	—	—
Retained earnings					
Reserved for regulatory requirements	—	—	—	173,210	—
Unreserved	—	—	—	3,254,098	258,495
Total Retained Earnings	**–-**	**–-**	**–-**	**3,427,308**	**258,495**
Fund balances					
Reserved for					
Encumbrances	1,740,237	4,899,734	117,775	—	—
Local agencies	—	—	—	—	—
Advances and loans	155,970	1,920,893	—	—	—
Employees' pension benefits	—	—	—	—	—
Continuing appropriations	1,436,716	3,638,873	63,368	—	—
Other specific purposes	—	—	—	—	—
Total Reserved	**3,332,923**	**10,459,500**	**181,143**	**–-**	**–-**
Unreserved					
Undesignated	4,245,392	2,715,442	40,261	—	—
Total Fund Equity and Other Credits	**7,578,315**	**13,174,942**	**221,404**	**3,723,792**	**605,578**
Total Liabilities, Fund Equity, and Other Credits	**$ 17,550,661**	**$ 24,398,714**	**$ 246,596**	**$ 33,572,293**	**$ 1,615,043**

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

Fiduciary Fund Type	Account Groups		Total Primary	Component Units		Total Reporting
Trust and Agency	General Fixed Assets	General Long-Term Obligations	Government (Memorandum Only)	University of California	Special Purpose Authorities	Entity (Memorandum Only)
$ 6,211,446	$ —	$ —	$ 12,516,663	$ 2,397,675	$ 39,439	$ 14,953,777
8,058,380	—	—	17,408,882	—	—	17,408,882
20,375	—	—	240,532	135,157	—	375,689
4,097,264	—	—	10,773,319	—	20,114	10,793,433
—	—	—	—	—	153,594	153,594
—	—	—	348,432	—	—	348,432
31,064	—	—	6,857,435	—	—	6,857,435
2,048,351	—	—	2,057,670	—	—	2,057,670
502,313	—	—	1,365,914	—	5,563,175	6,929,089
841,456	—	—	860,800	1,085,684	126,013	2,072,497
2,977	—	—	40,263	—	9,734	49,997
—	—	—	2,844,874	—	—	2,844,874
—	—	1,305,581	1,521,463	403,382	39,603	1,964,448
—	—	452,045	4,823,145	894,751	—	5,717,896
—	—	3,341,452	3,408,400	1,164,555	—	4,572,955
199,858	—	—	928,597	—	233,959	1,162,556
—	—	20,442,250	23,800,520	—	—	23,800,520
—	—	814,605	9,617,493	3,111,890	7,827,167	20,556,550
—	—	—	161,788	—	144,180	305,968
32,034,826	—	—	32,034,826	12,459,564	—	44,494,390
5,692,800	—	2,473,074	9,038,377	—	774,258	9,812,635
59,741,110	**—**	**28,829,007**	140,649,393	**21,652,658**	**14,931,236**	177,233,287
—	—	—	643,567	—	21,213	664,780
—	18,159,778	—	18,159,778	13,368,849	—	31,528,627
—	—	—	173,210	—	737,503	910,713
—	—	—	3,512,593	—	2,560,609	6,073,202
—	—	—	3,685,803	—	**3,298,112**	6,983,915
197,133	—	—	6,954,879	—	—	6,954,879
17,701,985	—	—	17,701,985	—	—	17,701,985
599,123	—	—	2,675,986	—	—	2,675,986
259,774,161	—	—	259,774,161	47,098,226	—	306,872,387
35,409	—	—	5,174,366	—	—	5,174,366
—	—	—	—	5,725,450	—	5,725,450
278,307,811	**—**	**—**	292,281,377	**52,823,676**	**—**	345,105,053
13,153,207	—	—	20,154,302	3,995,137	—	24,149,439
291,461,018	**18,159,778**	**—**	334,924,827	**70,187,662**	**3,319,325**	408,431,814
$ 351,202,128	**$ 18,159,778**	**$ 28,829,007**	$ 475,574,220	**$ 91,840,320**	**$ 18,250,561**	$ 585,665,101

(concluded)

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

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

All Governmental Fund Types and Expendable Trust Funds

Year Ended June 30, 2001
(amounts in thousands)

	Governmental Fund Types			Fiduciary Fund Type	Total Primary Government (Memorandum Only)
	General	Special Revenue	Capital Projects	Expendable Trust	
REVENUES					
Taxes	$ 75,604,723	$ 6,418,364	$ —	$ 5,861,140	$ 87,884,227
Intergovernmental	4,516	34,132,387	—	657,764	34,794,667
Licenses and permits	44,230	3,232,382	—	—	3,276,612
Natural resources	13,712	126,582	—	—	140,294
Charges for services	132,521	699,467	—	1,845	833,833
Fees and penalties	52,979	2,186,838	—	96,343	2,336,160
Investment and interest	833,320	512,623	20,161	176,770	1,542,874
Escheat	—	—	—	25,001	25,001
Receipts from depositors	—	—	—	682,081	682,081
Other	813,249	369,672	20,829	754,601	1,958,351
Total Revenues	**77,499,250**	**47,678,315**	**40,990**	**8,255,545**	133,474,100
EXPENDITURES					
Current					
General government	2,383,331	3,678,019	310	75,234	6,136,894
Education	34,140,713	6,713,351	6	1,550,666	42,404,736
Health and human services	19,829,984	29,531,069	—	5,311,955	54,673,008
Resources	1,810,957	1,703,206	1,976	28,788	3,544,927
State and consumer services	479,269	458,109	4,506	1,008	942,892
Business and transportation	158,904	8,129,114	105	23,883	8,312,006
Correctional programs	4,870,839	254,193	—	—	5,125,032
Property tax relief	2,799,373	887,000	—	—	3,686,373
Payments to depositors	—	—	—	263,121	263,121
Capital outlay	46,575	682,688	175,853	—	905,116
Debt service					
Principal retirement	1,184,441	10,989	35,917	—	1,231,347
Interest and fiscal charges	1,060,080	74,926	50,357	—	1,185,363
Total Expenditures	**68,764,466**	**52,122,664**	**269,030**	**7,254,655**	128,410,815
Excess (Deficiency) of Revenues Over (Under) Expenditures	**8,734,784**	**(4,444,349)**	**(228,040)**	**1,000,890**	5,063,285
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases	46,575	3,494,172	143,368	—	3,684,115
Proceeds from refunding long-term debt	—	4,169,265	250,400	—	4,419,665
Operating transfers in	249,360	8,776,038	119,454	663,254	9,808,106
Operating transfers out	(6,201,015)	(3,490,758)	(202)	(123,396)	(9,815,371)
Transfers out – component units	(3,618,709)	(40,789)	(18)	—	(3,659,516)
Payment to refunding escrow agent	—	(525,905)	(93,760)	—	(619,665)
Payment to refund commercial paper	—	(3,643,360)	(156,640)	—	(3,800,000)
Net Other Financing Sources (Uses)	**(9,523,789)**	**8,738,663**	**262,602**	**539,858**	17,334
Excess (Deficiency) of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses	**(789,005)**	**4,294,314**	**34,562**	**1,540,748**	5,080,619
Fund Balances, July 1, 2000	**8,367,320**	**8,880,628 ***	**186,842**	**12,444,124**	29,878,914
Fund Balances, June 30, 2001	**$ 7,578,315**	**$ 13,174,942**	**$ 221,404**	**$ 13,984,872**	$ 34,959,533

* Restated

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

Combined Statement of Revenues, Expenses, and Changes in Retained Earnings

All Proprietary Fund Types and Discretely Presented Component Units – Special Purpose Authorities

Year Ended June 30, 2001
(amounts in thousands)

	Proprietary Fund Types		Total Primary Government	Component Units	Total Reporting Entity
	Enterprise	Internal Service	(Memorandum Only)	Special Purpose Authorities	(Memorandum Only)
OPERATING REVENUES					
Lottery ticket sales	$ 2,894,842	$ —	$ 2,894,842	$ —	$ 2,894,842
Power sales	2,733,000	—	2,733,000	—	2,733,000
Services and sales	1,617,238	3,099,430	4,716,668	205,654	4,922,322
Earned premiums (net)	—	—	—	1,759,462	1,759,462
Investment and interest	273,359	201	273,560	489,499	763,059
Contributions	—	—	—	3,411	3,411
Rent	375,995	—	375,995	24,220	400,215
Other	16,027	11,304	27,331	60,061	87,392
Total Operating Revenues	**7,910,461**	**3,110,935**	11,021,396	**2,542,307**	13,563,703
OPERATING EXPENSES					
Lottery prizes	1,503,768	—	1,503,768	—	1,503,768
Power purchases (net of recoverable power costs)	2,637,000	—	2,637,000	—	2,637,000
Personal services	345,704	440,707	786,411	164,031	950,442
Supplies	11,174	39,876	51,050	—	51,050
Services and charges	1,654,102	2,540,538	4,194,640	176,648	4,371,288
Depreciation	117,305	97,494	214,799	17,139	231,938
Benefit payments	—	—	—	1,915,809	1,915,809
Interest expense	498,917	3,153	502,070	432,051	934,121
Amortization (recovery) of deferred charges	(90,501)	—	(90,501)	219,514	129,013
Total Operating Expenses	**6,677,469**	**3,121,768**	9,799,237	**2,925,192**	12,724,429
Operating Income (Loss)	**1,232,992**	**(10,833)**	1,222,159	**(382,885)**	839,274
NONOPERATING REVENUES (EXPENSES)					
Grants received	46,728	—	46,728	68,916	115,644
Grants provided	(15,786)	—	(15,786)	(68,916)	(84,702)
Investment and interest income	161,161	15,408	176,569	834,555	1,011,124
Interest expense and fiscal charges	(315,466)	(34)	(315,500)	(2,844)	(318,344)
Dividends paid	—	—	—	(104,146)	(104,146)
Lottery payments for education	(1,031,986)	—	(1,031,986)	—	(1,031,986)
Other	(85,697)	(4,642)	(90,339)	22,164	(68,175)
Total Nonoperating Revenues (Expenses)	**(1,241,046)**	**10,732**	(1,230,314)	**749,729**	(480,585)
Income (Loss) Before Contributions/Transfers	**(8,054)**	**(101)**	(8,155)	**366,844**	358,689
Capital contributions	63,947	27,372	91,319	488	91,807
Operating transfers in	41,961	23,566	65,527	—	65,527
Operating transfers in – primary government	—	—	—	20,141	20,141
Operating transfers out	(58,262)	—	(58,262)	—	(58,262)
Net Contributions/Transfers	**47,646**	**50,938**	98,584	**20,629**	119,213
Net Income	**39,592**	**50,837**	90,429	**387,473**	477,902
Retained Earnings, July 1, 2000	**3,387,716** *	**207,658**	3,595,374	**2,910,639** *	6,506,013
Retained Earnings, June 30, 2001	**$ 3,427,308**	**$ 258,495**	$ 3,685,803	**$ 3,298,112**	$ 6,983,915

* Restated

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

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Non-GAAP Budgetary Basis – Budget and Actual

All Governmental Cost Funds

Year Ended June 30, 2001
(amounts in thousands)

	General Fund		
	Budget	**Actual**	**Variance**
REVENUES			
Major taxes and licenses			
Bank and corporation taxes	—	$ 6,899,302	—
Cigarette and tobacco tax	—	126,664	—
Inheritance, estate and gift taxes	—	934,709	—
Insurance gross premiums tax	—	1,496,556	—
Vehicle license fees	—	26,337	—
Motor vehicle fuel tax	—	—	—
Personal income tax	—	44,614,298	—
Retail sales and use taxes	—	21,276,843	—
Other major taxes and licenses	—	292,832	—
Total Major Taxes and Licenses	**––**	**75,667,541**	**––**
Minor revenues	—	1,942,359	—
Total Revenues	**––**	**77,609,900**	**––**
EXPENDITURES			
Legislative, judicial, executive	$ 2,682,406	2,611,426	$ 70,980
State and consumer services	527,434	519,981	7,453
Business, transportation and housing	2,220,360	2,217,670	2,690
Trade and commerce	148,706	144,312	4,394
Resources	2,266,823	2,214,037	52,786
Environmental protection	396,966	384,450	12,516
Health and human services	20,641,969	19,869,373	772,596
Correctional programs	4,944,352	4,934,993	9,359
Education	37,724,338	37,608,492	115,846
General government			
Tax relief and shared revenues	5,324,829	5,258,766	66,063
Debt service	2,294,898	2,270,181	24,717
Other general government	148,913	93,692	55,221
Total Expenditures	**$ 79,321,994**	**78,127,373**	**$ 1,194,621**
OTHER FINANCING SOURCES (USES)			
Transfers from other funds	—	6,561,817	—
Transfers to other funds	—	(6,324,088)	—
Other additions and deductions	—	46,309	—
Total Other Financing Sources (Uses)	**––**	**284,038**	**––**
Excess (Deficiency) of Revenues and Other Sources Over (Under) Expenditures and Other Uses	**––**	**(233,435)**	**––**
FUND BALANCES			
Fund Balances, July 1, 2000, Restated	**––**	**9,250,955**	**––**
Fund Balances, June 30, 2001	**––**	**$ 9,017,520**	**––**

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

Other Governmental Funds			Total		
Budget	**Actual**	**Variance**	**Budget**	**Actual**	**Variance**
—	$ 20	—	—	$ 6,899,322	—
—	1,024,205	—	—	1,150,869	—
—	—	—	—	934,709	—
—	—	—	—	1,496,556	—
—	5,260,205	—	—	5,286,542	—
—	3,142,142	—	—	3,142,142	—
—	4,234	—	—	44,618,532	—
—	5,339,230	—	—	26,616,073	—
—	37,978	—	—	330,810	—
—	**14,808,014**	**—**	**—**	**90,475,555**	**—**
—	4,619,861	—	—	6,562,220	—
—	**19,427,875**	**—**	**—**	**97,037,775**	**—**
$ 618,040	481,782	$ 136,258	$ 3,300,446	3,093,208	$ 207,238
500,142	430,212	69,930	1,027,576	950,193	77,383
5,785,384	2,800,522	2,984,862	8,005,744	5,018,192	2,987,552
2,206	(3,479)	5,685	150,912	140,833	10,079
1,375,530	1,134,967	240,563	3,642,353	3,349,004	293,349
603,642	485,088	118,554	1,000,608	869,538	131,070
4,387,147	4,335,158	51,989	25,029,116	24,204,531	824,585
18,411	17,934	477	4,962,763	4,952,927	9,836
829,417	768,058	61,359	38,553,755	38,376,550	177,205
3,782,488	3,782,488	—	9,107,317	9,041,254	66,063
501	468	33	2,295,399	2,270,649	24,750
(263,697)	(340,782)	77,085	(114,784)	(247,090)	132,306
$ 17,639,211	**13,892,416**	**$ 3,746,795**	**$ 96,961,205**	**92,019,789**	**$ 4,941,416**
—	16,287,271	—	—	22,849,088	—
—	(18,375,806)	—	—	(24,699,894)	—
—	263,195	—	—	309,504	—
—	**(1,825,340)**	**—**	**—**	**(1,541,302)**	**—**
—	**3,710,119**	**—**	**—**	**3,476,684**	**—**
—	**6,652,860**	**—**	**—**	**15,903,815**	**—**
—	**$ 10,362,979**	**—**	**—**	**$ 19,380,499**	**—**

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

Combined Statement of Cash Flows

All Proprietary Fund Types and Discretely Presented Component Units – Special Purpose Authorities

Year Ended June 30, 2001 (amounts in thousands)	Proprietary Fund Types		Component Units
	Enterprise [1]	Internal Service [2]	Special Purpose Authorities [3]
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating income (loss)	$ 1,232,992	$ (10,833)	$ (382,885)
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATIONS			
Interest expense on operating debt	—	3,153	428,848
Depreciation	117,305	97,494	17,139
Accretion of capital appreciation bonds	9,753	—	28,123
Provisions and allowances	5,579	—	25,458
Accrual of deferred charges	(1,889)	—	(221,753)
Amortization of deferred credits	—	—	(3,586)
Amortization of discounts	1,391	—	6,553
Amortization (recovery) of deferred charges	(88,127)	—	218,044
Purchase of program loans	—	—	(1,540,632)
Collection of principal from program loans	115	—	693,640
Other	45,642	(1,327)	24,847
Change in assets and liabilities			
Receivables	(1,634,744)	4,039	(111,346)
Due from other funds	(17,144)	(55,166)	—
Due from primary government	—	—	(12,527)
Due from other governments	4,837	(847)	(808)
Prepaid items	(2,338)	(12,765)	(1,320)
Inventories	(2,920)	(2,344)	—
Net investment in direct financing leases	169,675	—	—
Advances and loans receivable	(146,973)	—	—
Recoverable power costs (net)	(6,127,000)	—	—
Other assets	(1,823)	835	25,338
Accounts payable	1,631,042	54,290	29,464
Interest payable	(13,297)	1,391	—
Due to other funds	177,514	99,515	—
Due to other governments	93,489	9,792	(1,274)
Benefits payable	226,874	9,524	500,733
Deposits	581	(168)	8,384
Lottery prizes and annuities	(131,599)	—	—
Contracts and notes payable	4,687	2,657	(1,132)
Compensated absences payable	1,265	2,729	6,572
Capital lease obligations	—	221	232
Advance collections	(7,688)	59,455	64,394
Other liabilities	(24,907)	(1,065)	(9,689)
Total Adjustments	**(5,710,700)**	**271,413**	**173,702**
Net Cash Provided by (Used in) Operating Activities	**(4,477,708)**	**260,580**	**(209,183)**

Non-cash transactions are those portions of investing, financing, or capital activities that affected assets and liabilities but did not result in cash receipts or payments during the period.

[1] Enterprise funds had the following non-cash transactions: a. $192 million in interest accreted on annuitized lottery prizes; b. $80 million in unclaimed lottery prizes directly transferred for educational purposes; c. $87 million unrealized gain and a $39 million unrealized loss on investments.

[2] Internal service funds had the following non-cash transactions: a. installment purchases totaling approximately $17 million to acquire equipment; b. $2 million unrealized gain on investments.

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

	Proprietary Fund Types		Component Units
	Enterprise [1]	Internal Service [2]	Special Purpose Authorities [3]
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Dividends paid	—	—	(95,939)
Advances from other funds	6,169,000	—	—
Collection of advances and loans	2,887	—	—
Return of advances from other funds	(32,258)	(74,719)	—
Proceeds from general obligation bonds	78,725	—	—
Proceeds from notes payable and commercial paper	4,300,000	—	—
Proceeds from revenue bonds	179,570	—	2,113,083
Retirement of general obligation bonds	(195,045)	—	—
Retirement of revenue bonds	(114,445)	—	(1,005,812)
Interest paid on operating debt	(93,000)	—	(428,925)
Operating transfers in	41,961	23,566	20,141
Operating transfers out	(58,263)	—	—
Grants provided	(15,786)	—	(68,916)
Lottery payments for education	(1,051,136)	—	—
Net Cash Provided by (Used in) Noncapital Financing Activities	**9,212,210**	**(51,153)**	**533,632**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Acquisition of intangible assets	—	(2,912)	—
Acquisition of fixed assets	(416,403)	(126,517)	(22,871)
Proceeds from sale of fixed assets	26	3,389	3
Advances from other funds	96,570	—	—
Advances and loans provided	(4,455)	—	—
Collection of advances and loans	19,332	—	—
Return of advances from other funds	(23,779)	—	—
Proceeds from notes payable and commercial paper	67,743	7,113	—
Principal paid on notes payable and commercial paper	(28,117)	(4,432)	(534)
Payment of capital lease obligations	—	(2,598)	—
Retirement of general obligation bonds	(38,810)	—	—
Proceeds from revenue bonds	529,864	—	—
Retirement of revenue bonds	(679,822)	—	(2,676)
Interest paid	(221,480)	(3,153)	(2,937)
Contributed capital	63,947	27,372	488
Grants received	46,728	—	68,916
Payment to refunding escrow agent	(174,967)	—	—
Net Cash Provided by (Used in) Capital and Related Financing Activities	**(763,623)**	**(101,738)**	**40,389**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of investments	(260,904)	—	(2,929,506)
Proceeds from maturity and sale of investments	879,915	47,415	2,511,492
Advances and loans provided	(55,682)	—	(22,636)
Collection of advances and loans	—	—	424
Earnings on investments	120,390	15,401	552,264
Net Cash Provided by Investing Activities	**683,719**	**62,816**	**112,038**
Net Increase (Decrease) in Cash and Pooled Investments	**4,654,598**	**170,505**	**476,876**
Cash and Pooled Investments at July 1, 2000	**2,435,815**	**301,537**	**1,015,850**
Cash and Pooled Investments at June 30, 2001	**$ 7,090,413**	**$ 472,042**	**$ 1,492,726**

[3]Component units had the following non-cash transactions: a. $247 million unrealized gain on investments; b. $495 thousand in construction costs through the issuance of a note payable; c. $1 million litigation liability.

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

Combined Statement of Changes in Plan Net Assets

Pension Trust Funds and Discretely Presented Component Unit – University of California

Year Ended June 30, 2001
(amounts in thousands)

	Primary Government Pension Trust Funds	Component Unit University of California Retirement System Funds
ADDITIONS		
Contributions		
Employer	$ 3,290,732	$ 517
Plan member	3,640,052	619,735
Total Contributions	**6,930,784**	**620,252**
Investment income		
Net depreciation in fair value of investments	(31,189,682)	(4,603,596)
Interest, dividends, and other investment income	11,536,483	2,194,753
Less: Investment expense	(2,842,710)	(507,511)
Net Investment Loss	**(22,495,909)**	**(2,916,354)**
Other	12,404	—
Total Additions	**(15,552,721)**	**(2,296,102)**
DEDUCTIONS		
Benefits	9,855,502	712,427
Refunds of contributions	208,834	439,054
Administrative expense	240,561	33,334
Transfers among funds	—	934
Total Deductions	**10,304,897**	**1,185,749**
Net Decrease in Fund Balance Reserved for Employees' Pension Benefits	**(25,857,618)**	**(3,481,851)**
Fund Balance Reserved for Employees' Pension Benefits, July 1, 2000	**285,631,779**	**50,580,077**
Fund Balance Reserved for Employees' Pension Benefits, June 30, 2001	**$ 259,774,161**	**$ 47,098,226**

Statement of Changes in Net Assets

Investment Trust Fund – Local Agency Investment

Year Ended June 30, 2001
(amounts in thousands)

CHANGE IN NET ASSETS RESULTING FROM OPERATIONS	
Investment and interest income	$ 873,411
Less: Operating expenditures and expenses	(1,720)
Net Increase in Net Assets Resulting From Operations	**871,691**
DISTRIBUTIONS TO PARTICIPANTS	
Distributions paid and payable	**(871,691)**
CHANGE IN NET ASSETS RESULTING FROM DEPOSITOR TRANSACTIONS	
Receipts from depositors	23,089,583
Less: Withdrawals by depositors	(17,915,986)
Net Increase in Net Assets Resulting From Depositor Transactions	**5,173,597**
Total Change in Net Assets	**5,173,597**
Net Assets Held in Trust for Pool Participants, July 1, 2000	**12,528,388**
Net Assets Held in Trust for Pool Participants, June 30, 2001	**$ 17,701,985**

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

Combined Balance Sheet

Discretely Presented Component Unit – University of California

June 30, 2001
(amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds	Agency Funds	Retirement System Funds	Total (Memorandum Only)
ASSETS							
Cash	$ 147,501	$ —	$ —	$ 4,545	$ —	$ —	$ 152,046
Investments	6,098,836	64,298	5,520,003	1,786,446	708,476	56,503,431	70,681,490
Receivables (net)	1,230,653	291,113	43,612	69,374	—	414,466	2,049,218
Due from primary government	204,796	—	—	17,996	—	—	222,792
Due from component units	212	—	35,372	1,379	—	98,194	135,157
Due from other governments	158,207	795	—	31,428	—	—	190,430
Inventories, at cost	111,922	—	—	1,491	—	—	113,413
Deferred charges	83,403	—	—	—	—	—	83,403
Fixed assets	—	—	—	18,205,528	—	—	18,205,528
Investment in UCSF Stanford Health Care	—	—	—	6,843	—	—	6,843
Total Assets	**$ 8,035,530**	**$ 356,206**	**$ 5,598,987**	**$ 20,125,030**	**$ 708,476**	**$ 57,016,091**	**$ 91,840,320**
LIABILITIES AND FUND EQUITY							
Liabilities							
Accounts payable	$ 1,630,137	$ 240	$ 107,783	$ 89,265	$ —	$ 570,250	$ 2,397,675
Due to component units	104,058	2,000	—	29,099	—	—	135,157
Deposits	377,208	—	—	—	708,476	—	1,085,684
Compensated absences	403,382	—	—	—	—	—	403,382
Commercial paper and other borrowings	1,034	—	—	893,717	—	—	894,751
Capital lease obligations	—	—	—	1,164,555	—	—	1,164,555
Revenue bonds payable	—	1,605	—	3,110,285	—	—	3,111,890
Securities lending obligation	2,277,820	—	834,129	—	—	9,347,615	12,459,564
Total Liabilities	**4,793,639**	**3,845**	**941,912**	**5,286,921**	**708,476**	**9,917,865**	**21,652,658**
Fund Equity							
Investment in general fixed assets	—	—	—	13,368,849	—	—	13,368,849
Fund balances							
Employees' pension benefits	—	—	—	—	—	47,098,226	47,098,226
Reserved for other specific purposes	1,141,573	323,241	3,681,542	579,094	—	—	5,725,450
Undesignated	2,100,318	29,120	975,533	890,166	—	—	3,995,137
Total Fund Equity	**3,241,891**	**352,361**	**4,657,075**	**14,838,109**	**—**	**47,098,226**	**70,187,662**
Total Liabilities and Fund Equity	**$ 8,035,530**	**$ 356,206**	**$ 5,598,987**	**$ 20,125,030**	**$ 708,476**	**$ 57,016,091**	**$ 91,840,320**

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

Combined Statement of Changes in Fund Balances

Discretely Presented Component Unit – University of California

Year Ended June 30, 2001
(amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds
REVENUES AND OTHER ADDITIONS				
Student tuition and fees	$ 1,189,515	$ —	$ —	$ 17,731
U.S. government	4,947,104	2,515	—	62,613
Local government	113,513	—	—	—
Sales and services				
Educational activities	779,711	—	—	—
Medical centers	2,856,719	—	—	—
Auxiliary enterprises	676,412	—	—	—
Private gifts, grants, and contracts	1,045,326	682	48,036	138,799
Investment income				
Endowment activities	158,621	—	8,778	—
Securities lending	144,776	—	—	—
Other	220,786	11,187	—	73,526
Net appreciation (depreciation) in fair value of investments	104,208	772	(501,074)	16,442
Expended for plant facilities (including $504,584 of current funds)	—	—	—	1,531,770
UCSF Stanford Health Care distributions (net)	—	—	—	(8,557)
Retirement of indebtedness	—	5,800	—	257,766
Other revenues	281,467	—	—	—
Transfers in – primary government	3,440,085	—	—	199,290
Other additions	56,627	4,770	48,959	10,153
Total Revenues and Other Additions	**16,014,870**	**25,726**	**(395,301)**	**2,299,533**
EXPENDITURES AND OTHER DEDUCTIONS				
Current fund expenditures				
Educational and general	8,310,815	—	—	—
Medical centers	2,729,610	—	—	—
Auxiliary enterprises	532,013	—	—	—
Department of Energy laboratories	3,070,379	—	—	—
Securities lending fees and rebates	138,085	—	—	—
Plant fund expenditures (including noncapitalized expenditures of $16,489)	—	—	—	425,988
Issuance of debt obligations	—	—	—	464,116
Debt service				
Principal retirement	—	5,800	—	253,509
Interest	—	—	—	257,144
Disposal of plant assets	—	—	—	228,515
Other	71,540	7,119	5,596	109,196
Total Expenditures and Other Deductions	**14,852,442**	**12,919**	**5,596**	**1,738,468**
TRANSFERS AMONG FUNDS				
Mandatory contractual arrangements				
Loan funds matching grants	(51)	51	—	—
Principal and interest	(338,211)	—	—	338,211
Nonmandatory (discretionary allocations)	(582,979)	215	62,809	520,889
Total Transfers Among Funds	**(921,241)**	**266**	**62,809**	**859,100**
Net Increase (Decrease) in Fund Balances	**241,187**	**13,073**	**(338,088)**	**1,420,165**
Fund Balances, July 1, 2000	**3,000,704 ***	**339,288**	**4,995,163**	**13,417,944 ***
Fund Balances, June 30, 2001	**$ 3,241,891**	**$ 352,361**	**$ 4,657,075**	**$ 14,838,109**

*Restated

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

Combined Statement of Current Funds Revenues, Expenditures, and Other Changes

Discretely Presented Component Unit – University of California

Year Ended June 30, 2001
(amounts in thousands)

	Current Funds		Total (Memorandum Only)
	Unrestricted	Restricted	
REVENUES			
Student tuition and fees	$ 1,189,515	$ —	$ 1,189,515
U.S. government appropriations, grants and contracts	363,585	1,487,872	1,851,457
Local government grants and contracts	2,438	118,501	120,939
Sales and services			
Education activities	779,711	—	779,711
Medical centers	2,856,719	—	2,856,719
Auxiliary enterprises	676,412	—	676,412
Private gifts, grants and contracts	91,264	942,311	1,033,575
Investment income			
Endowment and similar funds	36,371	122,250	158,621
Securities lending	97,232	47,544	144,776
Other	199,561	21,225	220,786
Net appreciation in fair value of investments	71,133	33,075	104,208
Department of Energy laboratories	31,118	3,070,379	3,101,497
Other revenues	281,467	—	281,467
Transfers in – primary government	2,968,857	398,670	3,367,527
Total Revenues	**9,645,383**	**6,241,827**	15,887,210
EXPENDITURES AND MANDATORY TRANSFERS			
Educational and general			
Instructional	2,397,811	183,919	2,581,730
Research	391,534	1,927,468	2,319,002
Public service	237,746	156,973	394,719
Academic support	919,080	141,053	1,060,133
Student services	324,390	18,550	342,940
Institutional support	593,035	45,167	638,202
Operation and maintenance of plant	430,727	1,104	431,831
Student financial aid	200,211	342,047	542,258
Mandatory transfers			
Loan fund matching grant	(181)	232	51
Debt service	118,205	108,720	226,925
Total Educational and General Expenditures, and Mandatory Transfers	**5,612,558**	**2,925,233**	8,537,791
Medical centers			
Expenditures	2,723,723	5,887	2,729,610
Mandatory transfers	59,194	—	59,194
Total Medical Centers	**2,782,917**	**5,887**	2,788,804
Auxiliary enterprises			
Expenditures	524,735	7,278	532,013
Mandatory transfers	52,092	—	52,092
Total Auxiliary Enterprises	**576,827**	**7,278**	584,105
Department of Energy laboratories	—	3,070,379	3,070,379
Securities lending fees and rebates	92,824	45,261	138,085
Total Expenditures and Mandatory Transfers	**9,065,126**	**6,054,038**	15,119,164
OTHER TRANSFERS AND ADDITIONS (DEDUCTIONS)			
Restricted receipts in excess of restricted expenditures	—	71,033	71,033
Nonmandatory transfers	(493,998)	(88,981)	(582,979)
Other	(9,967)	(4,946)	(14,913)
Total Other Transfers and Additions (Deductions)	**(503,965)**	**(22,894)**	(526,859)
Net Increase in Fund Balances	**$ 76,292**	**$ 164,895**	$ 241,187

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

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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 Governmental Accounting Standards Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and GASB Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*, an amendment of GASB Statement No. 33, have been implemented in this report.

The following GASB Statements are required to be implemented for the year ending June 30, 2002, and will significantly change the presentation of the financial statements:

GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, except for the retroactive provisions for infrastructure;

GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, an amendment of GASB Statement No. 34;

GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, an amendment of GASB Statements No. 21 and No. 34; and

Certain provisions of GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

Under the new standards, the financial report should consist of the management's discussion and analysis (MD&A), basic financial statements, and required supplementary information. The MD&A should provide an analytical overview of the government's financial activities. The basic financial statements should include the

government-wide financial statements, fund financial statements, and notes to the financial statements.

In addition, the new standards require the government to report all capital assets, including infrastructure assets, in the government-wide statement of net assets and to report depreciation expense in the statement of activities. For the fund financial statements, the government is required to report separate columns for General Fund and for other major governmental and enterprise funds. The government is also required to present a summary reconciliation between the government-wide financial statements and the fund financial statements.

A. Reporting Entity

As required by GASB Statement No. 14, *The Financial Reporting Entity*, these financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, account groups, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. GASB Statement No. 14 does not modify the fiduciary fund reporting requirements of the primary government. As a result, funds such as the Public Employees' Retirement Fund and the State Teachers' Retirement Fund are reported in the appropriate fiduciary funds. Component units are organizations that are legally separate from the State but for which the State is financially accountable, or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The decision to include a potential component unit in the State's reporting entity is based on several criteria, including legal standing, fiscal dependency, and financial accountability. Following is information on blended and discretely presented component units for the State.

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, the $805 million of capital lease arrangements between the building authorities and the State has 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. Copies of the financial statements of the building authorities may be obtained from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5875.

Discretely presented component units are reported in separate columns in the combined financial statements. These units are legally separate from the primary government and mostly provide services to entities and individuals outside the State. For ease of presentation, discretely presented component units, other than the University of California, are included in the statements under the heading of special purpose authorities.

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. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act.

Copies of the University of California's separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

Special purpose authorities are presented in three separate categories for condensed financial statement reporting purposes: The State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and non-major component units. SCIF and CHFA are considered major component units, while all other special purpose authority component units are shown as non-major component units.

SCIF is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2000, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

CHFA was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CHFA's purpose is to meet 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 CHFA's governing board and has the authority to approve or modify its budget. Copies of CHFA's financial statements may be obtained from the California Housing Finance Agency, 1121 L Street, 7th Floor, Sacramento, California 95814.

State legislation created various non-major component units to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units, since they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit, since its exclusion from the statements would be misleading because of its relationship with the primary government. The balance of the non-major 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, the primary government can impose its will on the entity, or the entity provides a specific financial benefit to the primary government. Copies of the financial statements of these component units may be obtained from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5875. The non-major component units are:

The *California Alternative Energy and Advanced Transportation Financing Authority*, which provides financing for alternative energy and advanced transportation technologies;

The *California Infrastructure and Economic Development Bank*, which provides financing for business development and public improvements;

The *California Pollution Control Financing Authority*, which provides financing for pollution control facilities;

The *California Health Facilities Financing Authority*, which provides financing for the construction, equipping, and acquisition of health facilities;

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities;

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

The *district agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the

state (the district agricultural associations' financial report is as of and for the year ended December 31, 2000);

The *San Joaquin River Conservancy*, which was created to acquire and manage public lands within the San Joaquin River Parkway; and

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

A joint venture is an entity resulting from a contractual arrangement, that 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 with the Capitol Area Development Authority (CADA). CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2001, CADA had total assets of $15.3 million, total liabilities of $8.3 million, and reserved and unreserved retained earnings of $0.1 million and $5.9 million, respectively. Total revenues for the fiscal year were $6.5 million and expenses were $5.3 million, resulting in a net income of $1.2 million. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements can be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

The affiliation between the University of California, San Francisco (UCSF) Medical Center and Stanford University, creating UCSF

Stanford Health Care, a separate non-profit corporation, was terminated on March 31, 2000. The majority of the University of California's share of the net assets was distributed to the university on April 1, 2000. The university's remaining investment in UCSF Stanford Health Care is accounted for as a joint venture using the equity method of accounting.

Information on the finances of the joint venture may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

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 which is not financially accountable to the State.

Chapter 854 of the Statutes of 1996 created two state-chartered, non-profit market institutions, a Power Exchange and an Independent System Operator, to ensure a reliable supply of electricity. The Power Exchange is responsible for providing an efficient and competitive auction to meet the electricity loads of exchange customers; it is open on a non-discriminatory basis to all electricity providers. The Independent System Operator is responsible for providing centralized control of the statewide transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three Governor's appointees, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the two institutions and appoints governing boards that are broadly representative of the State's electricity users and providers. The State's accountability for these institutions does not extend beyond making the appointments. Since the primary government is not financially accountable for the Power Exchange and the Independent System Operator, the financial information of these two institutions is not included in the financial statements of this report.

In January 2001, the Power Exchange went bankrupt due to a spike in demand for electricity starting in the summer of 2000, coupled with a rise in the price of natural gas. Under the Governor's direction, the Department of Water Resources has assumed responsibility for purchasing power for the Power Exchange's customers.

The **Bay Area Toll Authority**, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base $2 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects.

Additional information on the Bay Area Toll Authority may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

B. Fund Accounting

The financial statements of the State are organized and operated on the basis of funds, account groups, and component units. A fund is an independent 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 minimum number of funds is maintained consistent with legal and managerial requirements.

An account group is a reporting device to account for certain assets and liabilities of the governmental funds that are not recorded directly in those funds.

A component unit is an organization that is legally separate from the State but for which the State is financially accountable, or for which the nature and significance of its relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete.

The financial activities of the State accounted for in the accompanying financial statements are classified as follows.

Governmental fund types are used primarily to account for services provided to the general public without charging directly for those services.

The State has the following three governmental fund types.

The *General Fund* is the main operating fund of the State. It accounts for transactions related to resources obtained and used for those services that do not need to be accounted for in another fund.

Special revenue funds account for transactions related to resources obtained from specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditures for specified purposes.

Capital projects funds account for transactions related to resources obtained and used to acquire or construct major capital facilities.

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. For its proprietary funds, the State

applies all applicable GASB pronouncements, pursuant to GASB Statement No. 20, as well as all applicable Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, unless the FASB statements and interpretations conflict with or contradict GASB pronouncements. However, with one exception, the State has elected not to apply FASB statements and interpretations issued after November 30, 1989. The exception is Prison Industries, an internal service fund, which has elected to follow FASB pronouncements issued after November 30, 1989, unless they conflict with or contradict GASB pronouncements.

The State has two proprietary fund types.

Enterprise funds account for goods or services provided to the general public on a continuing basis when (1) the State intends that all or most of the cost involved is to be financed by user charges, or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes.

Internal service funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis.

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.

The State has the following four fiduciary fund types.

Expendable trust funds account for assets held in a trustee capacity when principal, income, and earnings on principal may be expended in the course of a fund's designated operations.

Pension trust funds account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems.

Agency funds account for assets held by the State, which acts as an agent for individuals, private organizations, other governments, or other funds. Agency funds are custodial in nature and do not measure the results of operations.

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.

Account groups are used to establish control over and accountability for the government's general fixed assets and general long-term obligations.

The State has the following two account groups.

The *general fixed assets account group* accounts for governmental fixed assets not reported in a proprietary fund or a trust fund.

The *general long-term obligations account group* accounts for unmatured general obligation bonds and other long-term obligations generally expected to be financed from governmental funds.

Discretely presented component units are reported in separate columns in the combined financial statements to emphasize that they are legally separate from the primary government. The discretely presented component units are classified as the University of California and as special purpose authorities. The University of California's financial statements are prepared in conformity with GAAP, using the American Institute of Certified Public Accountants College and University Audit Guide model. As a result, the University of California's activities are accounted for in the following funds: current funds, loan funds, endowment and similar funds, plant funds, agency funds, and retirement system funds. Special purpose authorities account for their activities as enterprise funds.

C. Measurement Focus and Basis of Accounting

Governmental fund types and **expendable trust 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 unreserved fund balance is a measure of available spendable resources.

The accounts of the governmental fund types and expendable trust funds 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. Principal tax revenues susceptible to accrual are recorded as taxpayers earn income (personal income and bank and corporation taxes), as sales are made (consumption and use taxes), and as the taxable event occurs (miscellaneous taxes), net of estimated tax overpayments. Other revenue sources are recorded when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months.

Compensated absences are accounted for on a modified accrual basis of accounting. Except for expenditures in the General Fund for earned leave of academic-year faculty, compensated absences expenditures are not accrued because it is not anticipated that compensated absences will be used in excess of a normal year's accumulation.

Agency funds are custodial in nature and do not measure the results of operations. Assets and liabilities are recorded using the modified accrual basis of accounting.

Proprietary fund types, the **investment trust fund**, and **pension trust funds** are accounted for on the flow of economic resources measurement focus.

The accounts of the proprietary fund types, the investment trust fund, 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.

Lottery revenues 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, which are classified as the University of California and special purpose authorities, are accounted for on the flow of current resources and the flow of economic resources measurement focus, respectively. All use the full accrual basis of accounting.

D. Food Stamps

The distribution of food stamp benefits is recognized as revenues and expenditures in a special revenue fund, as required by GAAP. Revenues and expenditures are recognized when the benefits are distributed to the recipients. Food stamp balances held by the counties are reported as an asset and offset by deferred revenue. Revenues, expenditures, and balances of food stamp benefits are measured based on face value.

E. Inventories

Inventories are primarily stated at either the lower of average cost or market, or at cost utilizing the weighted average valuation method. In governmental fund types, inventories are recorded as expenditures when purchased. In proprietary fund types, inventories are expensed when consumed.

The discretely presented component units have inventory policies similar to those of the primary government.

F. Net Investment in Direct Financing Leases

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the

University of California, and certain local agencies. The payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board to finance the construction of facilities and energy efficiency projects. Upon expiration of the leases, jurisdiction of the facilities and projects will be with the primary government agency, the University of California, or the local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

G. Deferred Charges

The deferred charges account primarily represents operating and maintenance costs and unrecovered capital costs in the enterprise fund type that will be recognized as expenses over the remaining life of long-term State water supply contracts. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts.

H. Fixed Assets

The **general fixed assets account group** includes capital assets that are not assets of any specific fund, but rather of the primary government as a whole. Most of these assets arise from the expenditure of the financial resources of governmental funds and expendable trust funds used to acquire or construct them. The general fixed assets account group does not include fixed assets of proprietary funds or pension trust funds. These fixed assets are accounted for in their respective funds.

The general fixed assets account group is presented in the financial statements 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. Accumulated depreciation is not recorded in the general fixed assets account group. Purchased fixed assets are stated at historical cost. Tangible and intangible property are capitalized if the property has a normal useful life of at least one year and an acquisition cost of at least $5,000.

Proprietary fund type fixed assets, consisting of property, plant, and equipment, are stated at cost at the date of acquisition, less accumulated depreciation. They are depreciated over their estimated useful or service lives, ranging from 2 to 100 years, using the straight-line method of depreciation. Dormitory facilities, which represent 17.9% of the fixed assets of the enterprise funds, are not depreciated.

The fixed assets of the **discretely presented component units** are stated at cost at the date of acquisition, or at fair market value at

the date of donation in the case of gifts. Depreciation on the majority of the fixed assets of the discretely presented component units is not recorded, which is consistent with GAAP.

I. Long-Term Obligations

The primary government reports long-term obligations of governmental funds in the general long-term obligations account group. 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 trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, and the primary government's share of the University of California pension liability.

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of the building authorities, which are included in capital projects funds, the liability for revenue bonds is recorded in the respective fund.

J. Compensated Absences

In the governmental funds, only the amounts of compensated absences that normally would be liquidated with expendable available financial resources are accrued at year-end, such as costs of academic-year faculty. The costs of the academic-year faculty represent services rendered over a ten-month period that are paid for over a 12-month period. The balance of the amounts owed for services rendered is reported as a current liability in the General Fund. Unless it is anticipated that compensated absences will be used in excess of a normal year's accumulation, no additional liabilities are accrued. As a result, the unpaid liability for governmental funds is recorded in the general long-term obligations account group. Accumulated sick-leave balances are not included in the compensated absences because they do not vest to employees. However, unused sick-leave balances convert to service credits upon retirement.

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 a similar manner as the proprietary funds in the primary government.

K. Fund Equity

Fund equity accounts represent the difference between assets and liabilities of a fund. The fund equity accounts consist of *contributed capital* and *retained earnings* for proprietary funds and certain component units, *investment in general fixed assets* for the general

fixed assets account group and certain component units, and *fund balances* for governmental funds, trust funds, and certain component units.

Contributed capital is the permanent fund capital of a proprietary fund. In the past, contributed capital was created when a residual equity transfer was received by a proprietary fund, when a general fixed asset was "transferred" to a proprietary fund, or when a grant was received that was externally restricted to capital acquisition or construction. As described in Note 17, capital contributions are now recognized as revenues.

Retained earnings are divided into two sections: *reserved for regulatory requirement*s and *unreserved*. The reserved for regulatory requirements section represents a segregation of the retained earnings in enterprise funds and certain component units for amounts that are unavailable for general use as a result of specific legal requirements. Unreserved retained earnings represent the accumulated earnings of proprietary funds and certain component units that are not reserved for any specific purpose.

The fund balances for governmental funds and trust funds are divided into two sections: *reserved* and *unreserved-undesignated*. 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 balances that are legally segregated for specific uses. The reserves of the fund balance for governmental funds, trust funds, and certain component units are as follows.

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

Reserved for local agencies represents amounts held on behalf of local governments and local public agencies in the Local Agency Investment Fund, an investment trust fund.

Reserved for advances and loans receivable represents advances to other funds and the non-current portion of loans receivable that do not represent expendable available financial resources.

Reserved for employees' pension benefits represents reserves of the pension trust funds and the University of California, a discretely presented component unit. These reserves include accumulated contributions made by employees and employers, and undistributed interest and investment earnings.

Reserved for 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 other specific purposes includes amounts of the University of California, a discretely presented component unit, that are not available for future appropriations other than those for which the fund was established.

The *unreserved-undesignated* amounts represent the net of total fund balance, less reserves, for governmental funds, trust and agency funds, and certain component units.

Investment in general fixed assets represents the fixed assets of the governmental funds and expendable trust funds reported in the general fixed assets account group and the fixed assets of the University of California, a discretely presented component unit, that are restricted for specific purposes.

L. Restatement of Beginning Fund Equity

The beginning fund balance of the special revenue funds has been reduced by $50 million for corrections related to the prior year statements. The beginning retained earnings of the enterprise funds has been increased by $109 million for corrections related to the prior year statements. The beginning retained earnings of the discretely presented component units has been increased by $2 million for corrections related to the prior year statements.

The beginning fund balance of the University of California has been increased by $128 million as a result of the implementation of GASB Statement No. 33, which establishes accounting and financial reporting standards for transactions in which the university receives value without directly giving equal value in exchange. Gifts are recorded as revenue when received. Unconditional pledges of private gifts are recorded as revenue in the year promised, and state capital appropriations received in advance of the capital expenditure are recorded as deferred revenue, or accrued revenue if not received in advance of the capital expenditure.

M. 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.

N. Memorandum-Only Total Columns

Total columns captioned "memorandum only" do not represent consolidated financial information and are presented only to facilitate financial analysis. The columns do not present information that reflects financial position, results of operations, or cash flows, in accordance with GAAP. Interfund eliminations have not been made in the aggregation of this data.

NOTE 2. BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues; however, revenues are not included in the 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.

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 the encumbrances lapses.

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 goods and services are received. The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Non-GAAP Budgetary Basis - Budget and Actual, includes all of the current-year expenditures for governmental cost funds and their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures. Negative budget and expenditure amounts for other

general government can result when current encumbrances are significantly higher than prior year encumbrances.

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. Certain items that are established at the category, program, component, or element levels can be adjusted by the Department of Finance. For example, an appropriation for support may have detail accounts for personal services, operating expenses and equipment, and reimbursements. The Department of Finance can authorize adjustments between the detail accounts but cannot increase the amount of the overall support appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control, or the extent to which management may amend the budget without seeking approval of the governing body, has been established in the Budget Act at the appropriation level for the annual operating budget.

The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Non-GAAP Budgetary Basis - Budget and Actual, 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 *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.112. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5875.

C. Reconciliation of Budgetary Basis with GAAP Basis

The State annually reports its financial condition based on GAAP (GAAP basis) and on the State's budgetary provisions (budgetary basis). The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Non-GAAP Budgetary Basis - Budget and Actual, is compiled on the budgetary basis. The differences between budgetary basis fund balances and the fund equity prepared in accordance with GAAP are explained and reconciled in the following paragraphs and in Table 1, page 42.

The beginning fund balance 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 prior year accrual of revenues. A prior year expenditure adjustment results when the actual amount paid in the current year differs from the prior year accrual for appropriations whose ability to encumber funds has lapsed in previous periods. The beginning fund balance on a GAAP basis is not affected by this adjustment.

Perspective Difference

Fund classification: On a budgetary basis, the State's funds are classified as either governmental cost funds or nongovernmental cost funds. The governmental cost funds consist of the General Fund and other governmental cost funds into which revenues from taxes, licenses, and fees that support the general operations of the State are deposited. The nongovernmental cost funds consist of funds that are not subject to annual appropriated budgets and that derive their receipts from sources other than general and special taxes, licenses, fees, or other state revenues. On a GAAP basis, the financial information is classified as governmental, proprietary, or fiduciary funds, or as component units.

Basis Difference

Advances and loans receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The General Fund had education loans outstanding as of June 30, 2001, of $225 million, which will be forgiven and charged to expenditures in the year of appropriation on a budgetary basis. On a GAAP basis, these education loans were charged to expenditures for the year ended June 30, 1996, the year that the agreement was made to forgive the loans. The adjustments related to advances and loans caused a decrease to the fund equity of $194 million in the General Fund and an increase to the fund equity of $1.9 billion in special revenue funds, $353 million in enterprise funds, $599 million in trust and agency funds, and $22 million in component units.

Escheat property: A liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is not reported on a budgetary basis, while it is required to be reported on a GAAP basis. This adjustment caused a $617 million decrease to the General Fund balance.

Authorized and unissued bonds: General obligation bonds that are not self-liquidating are recorded as additions to the fund balance for the special revenue and capital projects funds on the budgetary basis when voters authorize the sale of bonds. However, in

accordance with GAAP, only the bonds issued during the year are recorded as additions to the fund balance. The adjustments related to authorized and unissued bonds caused a decrease to the fund balance of $7.4 billion in special revenue funds and $295 million in capital projects funds.

Provision for long-term obligations: On the budgetary basis, a provision for long-term obligations is used to offset certain bonds payable. However, in accordance with GAAP, this account is not used for enterprise funds. This adjustment caused a $2.8 billion decrease to the enterprise fund equity.

Encumbrances: The State does not record certain encumbrances on a budgetary basis that are recorded on a GAAP basis. The adjustments related to encumbrances caused an increase to the fund equity of $679 million in special revenue funds and $43 million in enterprise funds.

Fixed assets: For certain enterprise programs, the budgetary basis uses the modified accrual basis of accounting for fixed assets, which expenses fixed asset costs. In accordance with GAAP, fixed assets for enterprise funds should be capitalized and depreciated using the accrual basis of accounting. This adjustment caused a $1.5 billion increase to the enterprise fund equity.

Fund balances in agency funds: Fund balances are reported in agency funds on the budgetary basis. In accordance with GAAP, agency funds do not have a fund balance since they account for assets held solely in a custodial capacity. Accordingly, assets in agency funds are always matched with liabilities. This adjustment caused a $28.1 billion decrease to the agency fund balance.

California accounting practices for insurance: The financial statements of the State Compensation Insurance Fund (SCIF) on a budgetary basis are prepared in conformity with accounting practices prescribed by the Department of Insurance of the State of California. The principal differences between this method and GAAP are that investments are carried at amortized cost rather than fair value and policy acquisition costs are charged to current operations rather than being deferred. These adjustments caused a $152 million increase to the discretely presented component units fund equity.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused an increase to the fund equity of $101 million in the General Fund, $69 million in capital projects funds, $123 million in enterprise funds, $240 million in trust and agency funds, and $77 million in component units, and a

decrease in fund equity of $36 million in special revenue funds and $27 million in internal service funds.

Timing Difference

Liabilities budgeted in subsequent years: The primary government does not, on a budgetary basis, 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 a net decrease to the fund balance of $729 million in the General Fund and $129 million in special revenue funds.

Entity Difference

Entities not included in the State's accounting system: A fund for the trial courts in the special revenue funds, and some discretely presented component units are not included in the budgetary basis accounting system, but they are included on a GAAP basis. These adjustments caused an increase to the fund equity of $235 million in the special revenue funds and $70.6 billion in the component units, of which $70.2 billion is related to the University of California.

Table 1

Reconciliation of Budgetary Basis Fund Balance and GAAP Basis Fund Equity

June 30, 2001
(amounts in thousands)

	Total Budgetary Fund Classifications	Primary Government						Component Units
		Governmental Fund Types			Proprietary Fund Types		Fiduciary Fund Types	
		General	Special Revenue	Capital Projects	Enterprise	Internal Service	Trust and Agency	
Perspective Difference								
Budgetary/Legal basis annual report								
General Fund	$ 9,017,520	$ 9,017,520	$ —	$ —	$ —	$ —	$ —	$ —
Other governmental cost funds	10,362,979	—	10,071,326	89,497	352	11,483	189,973	348
Non-governmental cost funds	334,579,656	—	7,878,788	357,508	4,468,626	621,591	318,553,638	2,699,505
Total Budgetary Fund Balances Reclassified into GAAP Statement Fund Structure	**$ 353,960,155**	**9,017,520**	**17,950,114**	**447,005**	**4,468,978**	**633,074**	**318,743,611**	**2,699,853**
Basis Difference								
Advances and loans receivable		(193,721)	1,920,893	—	353,412	—	599,123	22,212
Escheat property		(617,208)	—	—	—	—	—	—
Authorized and unissued bonds		—	(7,445,000)	(294,739)	—	—	—	—
Provision for long-term obligations		—	—	—	(2,791,186)	—	—	—
Encumbrances		—	679,299	—	43,494	—	—	—
Fixed assets		—	—	—	1,525,933	—	—	—
Fund balances in agency funds		—	—	—	—	—	(28,121,454)	—
California accounting practices for insurance		—	—	—	—	—	—	152,132
Other		100,838	(36,485)	69,138	123,161	(27,496)	239,738	77,283
Timing Difference								
Liabilities budgeted in subsequent years		(729,114)	(129,339)	—	—	—	—	—
Entity Difference								
Entities not included in the State's accounting system		—	235,460	—	—	—	—	70,555,507
GAAP Fund Equity, June 30, 2001		**$ 7,578,315**	**$ 13,174,942**	**$ 221,404**	**$ 3,723,792**	**$ 605,578**	**$ 291,461,018**	**$ 73,506,987**

NOTE 3. DEPOSITS AND INVESTMENTS

The State reports investments at fair value. State statutes authorize investments in certain types of securities. 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). There is a single portfolio of investments with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner as described below. In addition, certain programs have the authority to separately invest their funds.

The State's pooled investment program and certain other programs of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to have investments in United States government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments.

The State Treasurer's Office administers a pooled investment program for the primary government and for certain special purpose authorities. As of June 30, the special purpose authorities' cash and pooled investments were approximately 4% 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. The State Treasurer's Office maintains cash deposits with certain banks that do not earn interest income. Income earned on these deposits compensates the banks for services and uncleared checks that are deposited in the pooled investment program's accounts.

All demand and time deposits, totaling approximately $5.6 billion, that were held by financial institutions as of June 30, 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 collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with fiscal agents totaling $15 million. Approximately $2 million of these deposits is related to principal and interest payments due to bondholders. The remaining $13 million represents a compensating balance account designed to provide sufficient earnings to cover fees

for custodial services and system maintenance. Most of these deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of all securities in the State Treasurer's Office pooled investment program is based on quoted market prices. As of June 30, the average remaining life of the securities in the pooled money investment program administered by the State Treasurer's Office was approximately 187 days.

The Pooled Money Investment Board provides regulatory oversight over the State Treasurer's pooled investment program. The purpose of the board is to design 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 consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of temporarily idle money available for investment. The State Treasurer is charged with making the actual investment transactions for this investment program. This program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits of 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, 2001, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled money investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, they are part of the State's reporting entity. The remaining participation in the Local Agency Investment Fund is all voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. The earnings on the investments related to those funds are legally required to be assigned to the State's General Fund. Most of the $823 million in interest revenue received by the General Fund from the pooled money investment program comes from these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants on a quarterly basis 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 method differs from the fair value method used to value investments in these financial statements because 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. Since the total difference between the fair values of the investments in the pool and the values 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 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.

The fair value, the ranges of interest rates, and the maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 4.

Tables 2 and 3 present summary financial statements of the Local Agency Investment Fund, an investment trust fund.

Table 2

Condensed Statement of Net Assets – Local Agency Investment Fund
June 30, 2001
(amounts in thousands)

Assets	
Cash and pooled investments	$ 17,692,124
Due from other funds	244,159
Total Assets	**$ 17,936,283**
Liabilities	
Due to other funds	$ 478
Due to other governments	230,713
Other liabilities	3,107
Total Liabilities	**234,298**
Net Assets Held in Trust for Pool Participants	**$ 17,701,985**

Table 3

Condensed Statement of Changes in Net Assets – Local Agency Investment Fund
Year Ended June 30, 2001
(amounts in thousands)

Changes in net assets resulting from operations	$ 871,691
Distributions to participants	(871,691)
Changes in net assets resulting from depositor transactions	5,173,597
Total Change in Net Assets	**5,173,597**
Net Assets Held in Trust for Pool Participants, July 1, 2000	**12,528,388**
Net Assets Held in Trust for Pool Participants, June 30, 2001	**$ 17,701,985**

As of June 30, floating-rate notes and mortgage-backed assets comprised less than 4.5% of the pooled investments. For the floating-rate notes in the portfolio, the interest received by the State Treasurer's pooled investment program rises or falls as the underlying index rate rises or falls. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into repurchase agreements as part of its pooled investment program. A repurchase agreement consists of two simultaneous transactions. One is the purchase of securities by the State Treasurer's Office from a bank or dealer. The other is a commitment by the bank or dealer to repurchase the securities from the State Treasurer's Office at the same price, plus interest, at a mutually agreed-upon future date. As the investor, the State is protected by underlying specific government securities, which are pledged as collateral during the length of the investment. During the year ended June 30, the State Treasurer's Office entered into eight repurchase agreements, with a carrying value of approximately $920 million. As of June 30, the State Treasurer's Office did not have any repurchase agreements outstanding.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities.

If the dealers default on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's pooled investment program would suffer an economic loss equal to the difference between the market value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into 71 reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $6.7 billion. The maturities of investments made with the proceeds from reverse repurchase agreements were matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

Enterprise funds, internal service funds, trust and agency funds, and a building authority in the capital projects funds also make separate investments, which are presented at fair value. The California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) had $290.2 billion (97%) of these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution to invest in stocks, bonds, mortgages, real estate, and other investments.

The fair value of CalPERS' investments in securities is generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments, discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or at cost plus accrued interest, which approximates market value when market value is not available. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and

enters into forward foreign currency exchange contracts. Futures and options of approximately $144 million were held for investment purposes as of June 30, 2001. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in net assets. Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2001, CalPERS had approximately $142 million net exposure to losses from forward foreign currency exchange transactions related to the $32.8 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

The fair value of investments for CalSTRS is generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair value represents the most recent appraisals. Short-term investments are reported at cost, or amortized cost, which approximates fair value.

Purchases and sales of debt securities, equity securities, and short-term investments by CalSTRS are recorded on the trade date. Real estate equity transactions are recorded on the settlement date.

The State Constitution, state statutes, and agency policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents have been contracted to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by the lender or the borrower. Collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively, for both CalPERS and CalSTRS. As of June 30, 2001, there was no credit risk of exposure to borrowers because the amount of collateral held exceeded the amounts owed to the borrowers. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The contracts with the securities lending agents require them to indemnify CalPERS and CalSTRS if the borrowers fail to return the securities (or if the

collateral is not sufficient to replace the securities lent) or if the borrower fails to pay for income distributions by the securities' issuers while the securities are on loan.

For CalPERS, the average term of the overall loans managed by its four securities lending agents was 42 days, 22 days, 29 days, and 30 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that at June 30, 2001, had weighted average maturities of 147 days, 147 days, 172 days, and 120 days, respectively, for the four portfolios.

For CalSTRS, cash collateral received on each security loan was invested in short-term investments that at June 30, 2001, had a weighted average maturity of less than 90 days.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments totaling $87.1 billion. These investments are not subject to classification. All remaining investments reported as of June 30 are categorized in three categories of credit risk:

1. Insured or registered, or securities held by the State or its agent in the State's name;

2. Uninsured and unregistered, with securities held by the counterparty's trust department or by an agent in the State's name; and

3. Uninsured and unregistered, with securities held by the counterparty, its trust department, or an agent but not in the State's name.

The types of investments reported at year-end are representative of the types of investments made during the year. Furthermore, the credit risk associated with the investments reported at year-end is representative of the credit risk associated with investments made during the year.

Table 4 presents the risk categories of the primary government as of June 30.

Table 4

Schedule of Investments – Primary Government
June 30, 2001
(amounts in thousands)

	Interest Rates*	Maturity	Category 1	Category 2	Category 3	Total Fair Value
Pooled Investments **						
U.S. government securities	3.37 - 6.95	1 day – 5 years	$ 20,469,513	$ —	$ —	$ 20,469,513
Negotiable certificates of deposit	3.74 - 6.67	1 day – 1 year	8,187,946	—	—	8,187,946
Commercial paper	3.67 - 6.54	1 day – 150 days	14,537,088	—	—	14,537,088
Corporate bonds	5.26 - 6.65	1 day – 5 years	2,504,340	—	—	2,504,340
Bank notes	3.74 - 6.67	1 day – 1 year	1,651,276	—	—	1,651,276
Total Pooled Investments			**47,350,163**	**––**	**––**	**47,350,163**
Separately Invested Funds Subject to Categorization						
Equity securities			136,615,474	—	—	136,615,474
Securities lending collateral			32,034,826	—	—	32,034,826
Mortgage loans and notes			14,426,208	—	—	14,426,208
U.S. government and agencies			10,745,830	209,351	—	10,955,181
Debt securities – STRS			19,108,496	—	—	19,108,496
Corporate bonds			11,072,814	94,904	—	11,167,718
Commercial paper			1,286,048	—	—	1,286,048
Other investments			3,980,482	54,291	—	4,034,773
Total Separately Invested Funds Subject to Categorization			**229,270,178**	**358,546**	**––**	**229,628,724**
Separately Invested Funds Not Subject to Categorization						
Investments held by broker-dealers under securities loans with cash collateral						31,604,134
Real estate						17,923,941
Venture capital and private equity funds						7,148,443
Investment contracts						2,745,523
Mutual funds						2,609,992
Insurance contracts						24,598
Other						8,170,741
Total Separately Invested Funds Not Subject to Categorization						**70,227,372**
Total Investments			**$ 276,620,341**	**$ 358,546**	**$ ––**	**$ 347,206,259**

* These interest rates represent high and low monthly averages for each investment type during the year.
** Approximately 3.5% of the pooled investments are investments of special purpose authorities, which are discretely presented component units. For special purpose authorities' separately invested funds, see Table 6.

The investments of the University of California, a discretely presented component unit, are stated at fair value. All of the university's investments recorded in each fund group are associated with the University of California Retirement System (UCRS), General Endowment Pool (GEP), High Income Pool (HIP), or Short-Term Investment Pool (STIP) or are separately invested. Investments authorized by the regents for the UCRS, GEP, HIP, and other separate investments include equity securities, fixed-income securities, and a domestic and foreign indexed fund. The equity portion of the investment portfolio may include both domestic and foreign common and preferred stocks, along with a modest

exposure to private equities. Private equities include venture capital partnerships, buy-outs and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, along with certain AAA-rated mortgage-backed securities. These mortgage-backed securities are used to diversify the portfolio and reduce market risk exposure. Where donor agreements place constraints on allowable investments, assets associated with endowment and similar funds are invested in accordance with the terms of the agreements. Investments authorized by the regents for the STIP include fixed-income securities with a maximum maturity of five years. In addition, the regents have authorized loans, primarily to faculty members, under the university's Mortgage Origination Program, with terms up to 30 years.

The GEP and HIP are balanced portfolios in which a large number of individual endowment funds participate in order to benefit from diversification and economies of scale. The net assets of the endowment and similar fund groups are invested in either the GEP, the HIP, or the STIP or are separately invested. The separately invested funds cannot be pooled due to investment restrictions or income requirements. All of the University of California's fund groups participate in the STIP. Current funds to provide for the payroll, operating expenses, and construction expenditures of all campuses and medical centers are invested in the STIP until expended.

The UCRS contains funds associated with the University of California's defined benefit and defined contribution plans.

The University of California participates in a securities lending program as a means to augment income. Securities are lent to select brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of securities lent. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of securities lent. The university receives interest and dividends during the loan period as well as a fee from the brokerage firm. Securities on loan for cash collateral are not considered to be categorized. As of June 30, the university had no credit risk exposure to borrowers because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully

indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent, as an agent for the university, in a short-term investment pool in the university's name, with guidelines approved by the treasurer of the Board of Regents. As of June 30, the securities in this pool had a weighted average maturity of 142 days. Table 5 presents risk categories of the University of California investments as of June 30.

Table 5

Schedule of Investments – University of California – Discretely Presented Component Unit
June 30, 2001
(amounts in thousands)

	Category 1	Category 2	Category 3	Total Fair Value
Separately Invested Funds Subject to Categorization				
Equity securities	$ 27,519,987	$ —	$ —	$ 27,519,987
Securities lending collateral	12,470,281	—	—	12,470,281
U.S. government and agency securities	4,637,011	—	—	4,637,011
Corporate bonds	10,085,933	—	—	10,085,933
Other investments	636,595	—	—	636,595
Total Separately Invested Funds Subject to Categorization	**55,349,807**	**––**	**––**	**55,349,807**
Separately Invested Funds Not Subject to Categorization				
Investments held by broker-dealers under securities loans with cash collateral				12,045,340
Venture capital and private equity funds				892,761
Insurance contracts				299,770
Mutual funds				1,510,494
Mortgage loans				389,089
Other investments				194,229
Total Separately Invested Funds Not Subject to Categorization				**15,331,683**
Total Investments	**$ 55,349,807**	**$ ––**	**$ ––**	**$ 70,681,490**

The cash and pooled investments of the special purpose authorities, which are discretely presented component units, are primarily invested in the State Treasurer's pooled investment program. Additionally, state law, bond resolutions, and investment policy resolutions allow the authorities to invest in United States government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

The California Housing Finance Agency (CHFA), a discretely presented component unit, entered into interest-rate swap agreements to pay fixed rates of interest and receive floating rate payments. Certain swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled and/or anticipated reductions in the associated "bonds payable" category. The swap agreements are expected to reduce interest-rate risk associated with variable-rate bonds issued by CHFA. As of June 30, 2001, CHFA had interest-rate swap agreements of $1.7 billion in notional amounts. CHFA is potentially exposed to loss in the event that the counterparties are unable to perform to the terms of the agreements. However, CHFA does not anticipate nonperformance by the counterparties.

Table 6 presents the risk categories of the special purpose authorities' investments outside of the State Treasurer's pooled investment program as of June 30, 2001. Included in the investments of the special purpose authorities are the investments of SCIF as of December 31, 2000. SCIF represents 85% of the fair value of the authorities' investments.

Table 6

Schedule of Investments – Special Purpose Authorities – Discretely Presented Component Units *
June 30, 2001
(amounts in thousands)

	Category			
	1	2	3	Total Fair Value
Separately Invested Funds Subject to Categorization				
Securities lending collateral	$ 687,376	$	$	$ 687,376
U.S. government securities	627,430	—	—	627,430
Corporate bonds	3,483,121	—	—	3,483,121
Mortgage loans and notes	1,712,374	—	—	1,712,374
Commercial paper	32,103	—	—	32,103
Investment agreements	—	551,840	—	551,840
Other investments	194,296	—	—	194,296
Total Separately Invested Funds Subject to Categorization	**6,736,700**	**551,840**	**––**	**7,288,540**
Separately Invested Funds Not Subject to Categorization				
Investment agreements				1,312,333
Mutual funds				256,143
Total Separately Invested Funds Not Subject to Categorization				**1,568,476**
Total Investments	**$ 6,736,700**	**$ 551,840**	**$ ––**	**$ 8,857,016**

* For special purpose authorities pooled investments, see the footnote in Table 4.

The State Department of Insurance permits insurance companies to lend a certain portion of their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at approximately 102% of the fair value of securities loaned. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2000, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the custodian bank, and the state fund.

NOTE 4. DUE FROM OTHER FUNDS, DUE TO OTHER FUNDS, ADVANCES TO OTHER FUNDS, ADVANCES FROM OTHER FUNDS, DUE FROM PRIMARY GOVERNMENT, AND DUE TO COMPONENT UNITS

The balances of Due from Other Funds, Due to Other Funds, Advances to Other funds, Advances from Other Funds, Due from Primary Government, and Due to Component Units are shown in Table 7. The total Due from Other Funds is greater than the total Due to Other Funds by $6.2 billion. The total Advances to Other Funds is less than the total Advances from Other Funds by the same amount. The State anticipates that, within 12 months after June 30, 2001, the Electric Power Fund will issue long-term revenue bonds and use the proceeds to repay $6.2 billion owed to the General Fund. This situation results in the General Fund's asset being reported as Due from Other Funds, a current asset, and the Electric Power Fund's liability being reported as Advances from Other Funds, a long-term liability.

Table 7

Schedule of Due from Other Funds, Due to Other Funds, Advances to Other Funds, Advances from Other Funds, Due from Primary Government, and Due to Component Units

June 30, 2001 (amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances to Other Funds	Advances from Other Funds	Due from Primary Government	Due from Component Units	Due to Component Units
General Fund	**$ 12,854,223**	**$ 2,584,372**	**$ 44,649**	**$ 617,208**	**$ –-**	**$ –-**	**$ 121,371**
Special Revenue							
Federal	231,314	4,859,536	—	—	—	—	—
Transportation Construction	1,395,987	150,907	—	—	—	—	261
Transportation Safety	108,442	116,458	—	—	—	—	—
Business and Professions Regulatory and Licensing	47,270	46,569	4,201	—	—	—	—
Environmental and Natural Resources	276,374	275,897	—	—	—	—	—
Financing to Local Governments	40,716	21,873	—	—	—	—	—
Cigarette and Tobacco Tax	202,281	230,254	—	—	—	—	95,839
Local Revenue	245,653	49,797	—	—	—	—	—
Unemployment Programs	760,904	74,698	—	—	—	—	—
Financing to the Public	4,324	4,089	—	—	—	—	—
Trial Courts	170,972	6,934	—	—	—	—	—
Other Special Revenue	166,703	75,339	—	13,585	—	—	2,686
Total Special Revenue	**3,650,940**	**5,912,351**	**4,201**	**13,585**	**–-**	**–-**	**98,786**
Capital Projects							
Prison Construction	71	156	—	—	—	—	—
Higher Education Construction	790	4,421	—	—	—	—	—
Natural Resources Acquisition and Enhancement	35,773	249	—	—	—	—	—
Building Authorities	22,167	486	—	—	—	—	—
Other Capital Projects	1,261	5,201	—	—	—	—	—
Total Capital Projects	**60,062**	**10,513**	**–-**	**–-**	**–-**	**–-**	**–-**
Enterprise							
Housing Loan	10,803	358	—	—	—	—	—
Water Resources	71,640	50,391	19,877	—	—	—	—
Toll Facilities	1,250	8,667	—	—	—	—	—
California State University	17,329	17,160	—	—	—	—	—
Leasing of Public Assets	135,728	98,617	—	—	—	—	—
State Lottery	13,448	284,450	—	—	—	—	—
Electric Power	17,000	116,000	—	6,169,000	—	—	—
Public Employees' Benefits	18	2,617	—	—	—	—	—
Other Enterprise	38,712	4,622	—	2,500	—	—	—
Total Enterprise	**305,928**	**582,882**	**19,877**	**6,171,500**	**–-**	**–-**	**–-**
Internal Service							
Architecture Revolving	53,526	—	—	—	—	—	—
Service Revolving	83,563	159,848	—	—	—	—	—
Prison Industries	16,453	1,661	—	—	—	—	—
Stephen P. Teale Data Center	25,839	76	—	—	—	—	—
Health and Human Services Agency Data Center	78,428	3,000	—	—	—	—	—
Water Resources Revolving	60,916	74,640	—	19,877	—	—	—
Public Employees' Health Care	3,073	8,203	—	—	—	—	—
Equipment Service	16,204	12,489	—	—	—	—	—
Other Internal Service	148	467	—	4,201	—	—	—
Total Internal Service	**338,150**	**260,384**	**–-**	**24,078**	**–-**	**–-**	**–-**

(continued)

Table 7

Schedule of Due from Other Funds, Due to Other Funds, Advances to Other Funds, Advances from Other Funds, Due from Primary Government, and Due to Component Units (continued)

June 30, 2001 (amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances to Other Funds	Advances from Other Funds	Due from Primary Government	Due from Component Units	Due to Component Units
Expendable Trust							
Unemployment	9,638	49,981	—	—	—	—	—
School Employees	933	5,631	—	—	—	—	—
Unemployment Compensation Disability	23,184	17,110	—	—	—	—	—
California State University and Colleges Trust	7,960	15,580	—	—	—	—	—
Student Loan	470	7,271	—	—	—	—	—
Housing Loan	5,376	582	—	—	—	—	—
Unclaimed Property	23,432	—	617,208	—	—	—	—
Deferred Compensation Plan	—	241	—	—	—	—	—
Other Expendable Trust	28,187	3,432	—	—	—	—	2,600
Total Expendable Trust	**99,180**	**99,828**	**617,208**	**––**	**––**	**––**	**2,600**
Pension Trust							
Public Employees' Retirement	11,085	—	—	—	—	—	—
State Teachers' Retirement	7,850	3,360	—	—	—	—	—
Judges' Retirement	—	380	—	—	—	—	—
Judges' Retirement II	—	283	—	—	—	—	—
Legislators' Retirement	—	232	—	—	—	—	—
Teachers Health Benefit	26	86	—	—	—	—	—
Volunteer Firefighters	—	76	—	—	—	—	—
Peace Officers/Firefighters	—	33	—	—	—	—	—
Total Pension Trust	**18,961**	**4,450**	**––**	**––**	**––**	**––**	**––**
Agency							
Revenue Collecting and Disbursing	5,579,130	6,569,937	—	31,064	—	—	35
Deposit	20,662	856,900	—	—	—	—	—
Departmental Trust	4,025	331	—	—	—	—	—
Other agency	402,462	526,456	—	—	—	—	17,740
Total Agency	**6,006,279**	**7,953,624**	**––**	**31,064**	**––**	**––**	**17,775**
Investment Trust							
Local agency investment	244,159	478	—	—	—	—	—
Total Investment Trust	**244,159**	**478**	**––**	**––**	**––**	**––**	**––**
University of California							
Current Funds	—	—	—	—	204,796	212	104,058
Loan Funds	—	—	—	—	—	—	2,000
Endowment and Similar Funds	—	—	—	—	—	35,372	—
Plant Funds	—	—	—	—	17,996	1,379	29,099
Retirement System Funds	—	—	—	—	—	98,194	—
Total University of California	**––**	**––**	**––**	**––**	**222,792**	**135,157**	**135,157**
Special Purpose Authorities							
California Housing Finance Agency	—	—	2,500	—	—	—	—
Non-major component units	—	—	—	—	17,740	—	—
Total Special Purpose Authorities	**––**	**––**	**2,500**	**––**	**17,740**	**––**	**––**
Total	**$ 23,577,882**	**$ 17,408,882**	**$ 688,435**	**$ 6,857,435**	**$ 240,532**	**$ 135,157**	**$ 375,689**

(concluded)

NOTE 5. RESTRICTED ASSETS

Table 8 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds, except for $2.2 million in the internal service funds and $121 million for the building authorities in the capital projects funds.

Table 8

Schedule of Restricted Assets
June 30, 2001
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due from Other Funds	Other Assets
Primary Government				
Debt service	$ 869,043	$ 73,148	$ 637	$ 224
Construction	365,900	27,099	2,501	23
Deposits	5,651	—	—	—
Equipment repair and replacement	44,981	—	1,160	127
Operations	130	—	—	—
Other	32,909	—	—	—
Total Primary Government	**1,318,614**	**100,247**	**4,298**	**374**
Discretely Presented Component Units				
University of California				
Risk insurance	—	249,538	—	—
Debt service requirements	—	163,957	—	—
Plant acquisition, construction, and renovation	—	2,604	—	—
Plant renewal and replacement	—	489	—	—
Special Purpose Authorities				
Debt service	791,803	1,284,142	—	—
District fairs	1	—	—	—
Total Discretely Presented Component Units	**791,804**	**1,700,730**	**—**	**—**
Total All Restricted Assets	**$ 2,110,418**	**$ 1,800,977**	**$ 4,298**	**$ 374**

NOTE 6. NET INVESTMENT IN DIRECT FINANCING LEASES

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board.

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 9.

Table 9

Schedule of Minimum Lease Payments to Be Received by the State Public Works Board for the Primary Government
(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2002	$ 379,060	$ 105,862	$ 65,277	$ 550,199
2003	376,043	105,043	59,487	540,573
2004	372,164	105,139	59,020	536,323
2005	370,866	103,761	58,925	533,552
2006	354,314	98,816	58,670	511,800
Thereafter	3,539,912	1,168,836	592,685	5,301,433
Total Minimum Lease Payments	**5,392,359**	**1,687,457**	**894,064**	**7,973,880**
Less: Unearned income	2,159,529	689,191	331,169	3,179,889
Net Investment in Direct Financing Leases	**$ 3,232,830**	**$ 998,266**	**$ 562,895**	**$ 4,793,991**

NOTE 7. FIXED ASSETS

Table 10 is a summary of changes in the general fixed assets account group for the year ended June 30. Included in the general fixed assets account group are fixed assets related to capital leases totaling $3.8 billion.

Table 10

Schedule of Changes in General Fixed Assets
(amounts in thousands)

	Balance July 1, 2000	Additions	Deductions	Balance June 30, 2001
Land	$ 2,165,135	$ 118,308	$ 14,692	$ 2,268,751
Structures and improvements	11,948,210	605,776	233,086	12,320,900
Equipment	2,149,988	252,542	151,459	2,251,071
Construction in progress	1,292,141	245,528	218,613	1,319,056
Total	**$ 17,555,474**	**$ 1,222,154**	**$ 617,850**	**$ 18,159,778**

Table 11 summarizes the proprietary fund fixed assets of enterprise funds and internal service funds, and the fixed assets of the discretely presented component units as of June 30.

Table 11

Schedule of Fixed Assets for Proprietary Funds and Discretely Presented Component Units

June 30, 2001

(amounts in thousands)

Primary Government	Enterprise Funds	Internal Service Funds
State water projects	$ 4,495,092	$ —
Toll facilities	1,163,062	—
Other land, improvements, buildings and equipment	1,040,574	1,149,937
Construction in progress	551,015	585
Total Primary Government Fixed Assets	**7,249,743**	**1,150,522**
Less: Accumulated depreciation	2,156,481	612,629
Net Primary Government Fixed Assets	**$ 5,093,262**	**$ 537,893**

Discretely Presented Component Units	University of California	Special Purpose Authorities
Real estate		
Buildings and improvements	$ 10,197,706	$ 623,188
Land	331,929	50,502
Furniture and equipment	3,692,681	156,812
Libraries and collections	2,547,291	—
Construction in progress	1,435,921	895
Total Discretely Presented Component Unit Fixed Assets	**18,205,528**	**831,397**
Less: Accumulated depreciation	—	282,048
Net Discretely Presented Component Unit Fixed Assets	**$ 18,205,528**	**$ 549,349**

NOTE 8. LONG-TERM OBLIGATIONS

As of June 30, the primary government had long-term obligations totaling $28.8 billion. These obligations are not expected to be financed from current resources in the governmental funds. Long-term obligations consist of the liability for employees' compensated absences, certificates of participation and commercial paper, long-term capital lease obligations, unmatured general obligation bonds, unmatured revenue bonds, and other liabilities. The other liabilities consist of $1.2 billion for workers' compensation claims, $814 million for net pension obligations, $400 million owed for lawsuits, and the University of California pension liability of $95 million. These other liabilities do not have required payment schedules or will be paid when funds are appropriated. Of the total long-term obligations outstanding, 96% will be paid by the General Fund and 4% will be paid by special revenue funds. The changes in the general long-term obligations account group during the year ended June 30, 2001, are summarized in Table 12.

Table 12

Schedule of Changes in General Long-Term Obligations
(amounts in thousands)

	Balance July 1, 2000	Additions	Deductions	Balance June 30, 2001
Compensated absences payable	$ 1,227,649	$ 746,652	$ 668,720	$ 1,305,581
Certificates of participation and commercial paper	622,656	3,636,400	3,807,011	452,045
Capital lease obligations	3,407,790	46,575	112,913	3,341,452
General obligation bonds payable	17,838,290	3,793,815	1,189,855	20,442,250
Revenue bonds payable	843,850	—	29,245	814,605
Other liabilities	1,881,603	871,130	279,659	2,473,074
Total	**$ 25,821,838**	**$ 9,094,572**	**$ 6,087,403**	**$ 28,829,007**

NOTE 9. COMPENSATED ABSENCES

As of June 30, the estimated liability for compensated absences related to accumulated vacation and annual leave totaled approximately $2.0 billion. Of this amount, $1.3 billion is reported in the general long-term obligations account group, $72 million is reported in the proprietary fund types, $143 million is reported in the General Fund, and $443 million is reported in the discretely presented component units.

NOTE 10. CERTIFICATES OF PARTICIPATION

Debt service requirements for certificates of participation, which are financed by lease payments from the special revenue funds and the General Fund, are shown in Table 13.

Table 13

Schedule of Debt Service Requirements for Certificates of Participation – Primary Government

(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2002	$ 10,145	$ 6,525	$ 16,670
2003	10,005	6,136	16,141
2004	9,902	5,727	15,629
2005	9,799	5,290	15,089
2006	9,682	4,804	14,486
Thereafter	66,067	24,474	90,541
Total	**$ 115,600**	**$ 52,956**	**$ 168,556**

Debt service requirements for certificates of participation for the University of California, a discretely presented component unit, are shown in Table 14.

Table 14

Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit

(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2002	$ 10,045	$ 15,692	$ 25,737
2003	10,570	15,175	25,745
2004	11,205	14,482	25,687
2005	11,810	13,787	25,597
2006	12,415	13,175	25,590
Thereafter	238,020	123,253	361,273
Total	**$ 294,065**	**$ 195,564**	**$ 489,629**

NOTE 11. COMMERCIAL PAPER AND OTHER BORROWINGS

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to $1.5 billion and an enterprise fund commercial paper program for the Department of Water Resources of up to $100 million. Under these programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance.

To provide liquidity for the programs, a revolving credit agreement has been entered into with commercial banks equal to the authorized amount of commercial paper.

The current agreement, effective September 15, 1999, established the existing $1.5 billion limit on the amount of outstanding notes under the general obligation commercial paper program. As of June 30, 2001, the general obligation commercial paper program had $336 million in outstanding commercial paper notes and the enterprise fund commercial paper program had no outstanding notes.

The proceeds from the issuance of commercial paper are restricted primarily to construction costs of general obligation bond program projects and of certain water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is recorded in the general long-term obligations account group.

The primary government has other borrowing that consists of an interim loan for $4.3 billion to the Electric Power Fund. The interim loan was structured with both taxable and tax-exempt components of $2.3 billion and $2.0 billion, respectively. The interim loan is collateralized by revenues and investment income. The financing was structured as a term loan due to be paid on or before October 31, 2001, from the proceeds of the sale of long-term bonds. Because bonds were not issued by October 31, 2001, the interim financing converted to a three-year term loan with quarterly principal and interest payments.

The primary government has a Revenue Bond Anticipation Note (BAN) program that consists of borrowing up to $82 million for the development and construction of housing on certain campuses of the California State University. As of June 30, 2001, $68 million in BANs outstanding existed in anticipation of issuing housing revenue bonds to the public. A BAN program provided financing for up to $4.1 million for the Humbolt State University Student Union in anticipation of issuing student union revenue bonds to the public. As of June 30, 2001, the amount of BANs outstanding for this purpose was $3.4 million.

The University of California, a discretely presented component unit, has mortgages and other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately $51 million, are various

unsecured financing agreements with commercial banks that total approximately $23 million.

The University of California established in October 1996 a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted cash balance in the University of California's Short-Term Investment Pool. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is not secured by any encumbrance, mortgage, or other pledge of property and does not constitute a general obligation of the University of California Board of Regents. At June 30, 2001, outstanding tax-exempt and taxable commercial paper was $430 million and $120 million, respectively.

NOTE 12. LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30 is approximately $6.7 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Most primary government leases are classified as operating leases, in accordance with the applicable standards, and contain clauses providing for termination. It is expected that in the normal course of business most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of approximately $3.3 billion in the general long-term obligations account group and $67 million in internal service funds. Lease expenditures for the year ended June 30 amounted to approximately $688 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $3.2 billion. This amount represents 97% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include $805 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the leases, title passes to the primary government.

The costs of the buildings are reported in the general fixed assets account group and the revenue bonds and certificates of participation outstanding associated with the buildings are reported in the general long-term obligations account group. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements, pursuant to GASB Statement No. 14.

Future minimum lease commitments of the primary government are summarized in Table 15.

Table 15

Schedule of Future Minimum Lease Commitments – Primary Government
(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases: General Long–Term Obligations	Capital Leases: Internal Service Funds	Total
2002	$ 261,239	$ 391,391	$ 9,638	$ 662,268
2003	220,780	388,374	9,582	618,736
2004	156,580	384,498	8,970	550,048
2005	96,306	383,363	9,193	488,862
2006	69,612	366,768	5,692	442,072
Thereafter	189,867	3,729,459	46,003	3,965,329
Total Minimum Lease Payments	**$ 994,384**	**5,643,853**	**89,078**	**$ 6,727,315**
Less: Amount representing interest		2,302,401	22,130	
Present Value of Net Minimum Lease Payments		**$ 3,341,452**	**$ 66,948**	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2001, was approximately $2.3 billion. Table 16 presents the future minimum lease commitments for the University of California and the special purpose authorities as of June 30. Operating lease expenditures for the year ended June 30 amounted to approximately $124 million for discretely presented component units.

Table 16

Schedule of Future Minimum Lease Commitments – Discretely Presented Component Units
(amounts in thousands)

Year Ending June 30	University of California Capital	University of California Operating	Special Purpose Authorities Operating	Total
2002	$ 125,771	$ 61,129	$ 25,845	$ 212,745
2003	121,337	56,726	24,372	202,435
2004	115,151	50,456	18,997	184,604
2005	109,331	45,621	15,492	170,444
2006	104,799	36,650	12,776	154,225
Thereafter	1,243,872	119,943	47,218	1,411,033
Total Minimum Lease Payments	**1,820,261**	**$ 370,525**	**$ 144,700**	**$ 2,335,486**
Less: Amount representing interest	655,706			
Present Value of Net Minimum Lease Payments	**$ 1,164,555**			

NOTE 13. COMMITMENTS

The primary government has made commitments of $4.1 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the special revenue funds because the future expenditures related to these commitments are expected to be reimbursed from local governments and proceeds of approved federal grants. The ultimate liability will not accrue to the State.

As of June 30, 2001, the primary government had other commitments totaling $35.6 billion that are not included as a liability on the balance sheet. These commitments included loan and grant programs for housing, school building aid, harbor facilities, and rail system construction totaling approximately $1.3 billion. In addition to the loan and grant commitments, the primary government had approximately $882 million for the construction of water projects and the purchase of power, up to $69 million for the operation and maintenance of the California State Lottery's automated gaming system, and $33.3 billion for long-term power purchase contracts. The commitments are expected to be funded from existing program resources and from the proceeds of revenue and general obligation bonds to be issued.

As of June 30, the University of California and special purpose authorities, discretely presented component units, had other commitments that are not included as a liability on the balance sheet. The University of California had authorized construction

projects totaling $2.2 billion. Special purpose authorities had outstanding commitments to provide $455 million for loans under various housing revenue bond programs and $74 million for loans to other governments for infrastructure improvements.

NOTE 14. GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education; it 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 provided on their behalf.

General obligation bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included in the accounts 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, $11.4 billion of general obligation bonds had been authorized but not issued. This amount includes $4.0 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, $336 million in general obligation indebtedness has been issued in the form of commercial paper notes but not yet retired by long-term bonds.

Table 17 summarizes the changes in general obligation bond debt for the year ended June 30.

Table 17

Schedule of Changes in General Obligation Bond Debt
(amounts in thousands)

	General Long–Term Obligations	Enterprise Funds	Total
Balance, July 1, 2000	$ 17,838,290	$ 3,513,400	$ 21,351,690
Additions	3,793,815	78,725	3,872,540
Deductions	(1,189,855)	(233,855)	(1,423,710)
Balance, June 30, 2001	**$ 20,442,250**	**$ 3,358,270**	**$ 23,800,520**

Table 18 shows the debt service requirements for all general obligation bonds, including interest of $14.5 billion, as of June 30, 2001.

Table 18

Schedule of General Obligation Bonds Debt Service Requirements
(amounts in thousands)

Year Ending June 30	General Long–Term Obligations	Enterprise Funds
2002	$ 2,527,538	$ 332,630
2003	2,415,015	299,074
2004	2,252,193	296,648
2005	2,089,393	302,945
2006	1,946,831	306,997
Thereafter	21,424,825	4,152,598
Total	**$ 32,655,795**	**$ 5,690,892**

Current Year Defeasances: During the year ended June 30, 2001, the primary government issued approximately $359 million in veterans general obligation bonds, the proceeds of which were used to immediately refund previously issued veterans general obligation bonds of approximately $359 million. In addition, approximately $76 million of veterans general obligation bonds were refunded by veterans home-purchase revenue bonds (see Note 15, Revenue Bonds). The advance refunding reduced the debt service payments by $140 million and resulted in an economic gain of $14 million.

On October 17, 2000, the primary government issued $117 million in various purpose general obligation refunding bonds for an advance refunding of $125 million in outstanding general obligation bonds maturing in years 2008 to 2012. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been

removed from the general long-term obligations account group. This advance refunding reduced the debt service payments by $7 million and resulted in an economic gain of $4 million.

On November 29, 2000, the primary government issued $148 million in various purpose general obligation refunding bonds for an advance refunding of $146 million in outstanding general obligation bonds maturing in years 2005 to 2012. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the general long-term obligations account group. This advance refunding reduced the debt service payments by $4 million and resulted in an economic gain of $4 million.

On February 27, 2001, the primary government issued $354 million in various purpose general obligation refunding bonds for an advance refunding of $356 million in outstanding general obligation bonds maturing in years 2005 to 2017. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the general long-term obligations account group. This advance refunding reduced the debt service payments by $22 million and resulted in an economic gain of $10 million.

Prior Year Defeasance: In prior years, the primary government has placed the proceeds of the refunded bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on the defeased bonds. 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, 2001, the outstanding balance of general obligation bonds defeased in prior years was approximately $1.5 billion.

NOTE 15. REVENUE BONDS

Revenue bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included within the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of the authorities and agencies listed in the next section of this note. 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 are issued for

Water Resources, California State University, and Leasing of Public Assets. Revenue bonds are also issued to make loans to finance the acquisition of farms and homes by California veterans. When the farm and home loans financed by the revenue bonds are fully paid, the farms and homes become the property of private individuals.

Certain building authorities, under state law, may issue revenue bonds. These revenue bonds are included in the general long-term obligations account group. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds.

The University of California, a discretely presented component unit, issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, a special purpose authority, which is a discretely presented component unit, issues revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low- to moderate-income families. When the housing developments and home loans are fully paid, the housing developments and homes become the property of private individuals or entities.

Table 19 shows revenue bonds outstanding as of June 30.

Table 19

Schedule of Revenue Bonds Outstanding
June 30, 2001
(amounts in thousands)

Primary Government	
General Long-Term Obligations	
Building Authorities	
California State University	$ 29,915
Los Angeles	191,470
San Francisco	371,180
San Bernardino	58,950
Oakland	150,255
Riverside	12,835
Total General Long-Term Obligations	**814,605**
Enterprise Funds	
Housing Loan	570,940
Water Resources	2,426,415
California State University	487,453
Leasing of Public Assets	5,318,080
Total Enterprise Funds	**8,802,888**
Total Primary Government	**9,617,493**
Discretely Presented Component Units	
University of California	3,111,890
Special Purpose Authorities	7,827,167
Total Discretely Presented Component Units	**10,939,057**
Total	**$ 20,556,550**

Table 20 shows the debt service requirements as of June 30, 2001. The debt service requirements primarily represent bond principal payments. Table 20 includes certain unamortized refunding costs, premiums, discounts, and other costs not included in Table 19.

Table 20

Schedule of Revenue Bond Debt Service Requirements
(amounts in thousands)

	Primary Government		
Year Ending June 30	**General Long–Term Obligations**	**Enterprise Funds**	**Discretely Presented Component Units**
2002	$ 30,590	$ 347,238	$ 459,117
2003	31,975	359,759	247,265
2004	33,450	385,972	263,653
2005	35,080	401,752	283,360
2006	37,155	432,686	305,960
Thereafter	646,355	7,120,887	9,400,128
Total	**$ 814,605**	**$ 9,048,294**	**$ 10,959,483**

Current-Year Defeasances: For the year ended June 30, 2001, the primary government issued approximately $180 million of home purchase revenue bonds to refund approximately $104 million of outstanding revenue bonds, and $76 million of veterans general obligation bonds. The proceeds of those bonds that could not be called for immediate redemption were deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liabilities have been removed from the financial statements. The advance refunds reduced the debt service payments by $49 million and resulted in an economic gain of $5 million.

The primary government also issued approximately $163 million in revenue bonds for Leasing Of Public Assets to advance refund approximately $164 million of outstanding lease revenue bonds. After payment of approximately $2 million in underwriter discount, insurance, and other bond issuance costs, and receipt of approximately $13 million for original bond premium, together with other available moneys of $903,000, the net proceeds of approximately $174 million were deposited in various escrow accounts held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The advance refunding reduced the primary government's aggregate debt service payments by $9 million over the next 14 years and resulted in an economic gain of $6 million.

In May 2001, the primary government issued $261 million in Central Valley Project Water System Revenue Bonds, Series W, to advance refund $207 million of outstanding revenue bonds and redeem commercial paper borrowings of $41 million. The advance refunding reduced the primary government's aggregate debt service payments by approximately $11 million over the next 20 years and resulted in an economic gain of $8 million. The new proceeds of the advance refundings (after payment of underwriting refunding fees, other issuance costs, and deposits to the Debt Service Reserve Accounts) were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

For the year ended June 30, 2001, the California Housing Finance Agency (CHFA), a discretely presented component unit, issued $165 million of home mortgage revenue bonds at variable rates to refund $162 million in outstanding home mortgage revenue bonds. The refunding will decrease the debt service cash outflow for the

housing bonds by approximately $13 million and result in an economic gain of approximately $21 million. CHFA considered these debt refundings to be an in-substance defeasance and, accordingly, removed the redeemed bonds and related assets from the financial statements. The deferred loss from extinguishment of the debt was $3 million.

Prior Year Defeasances: 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, 2001, the outstanding balance of revenue bonds defeased in prior years was approximately $1.9 billion.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 2001, the outstanding balance of University of California revenue bonds defeased in prior years was $668 million.

NOTE 16. MAJOR TAX REVENUES

Tax revenues for the year ended June 30, 2001, are presented in Table 21.

Table 21

Schedule of Major Tax Revenues
Year Ended June 30, 2001
(amounts in thousands)

	General Fund	Special Revenue Funds	Expendable Trust Funds
Personal income	$ 44,629,742	$ —	$ —
Sales and use	21,346,386	5,038,838	—
Bank and corporation	6,580,178	—	—
Unemployment insurance	—	—	2,999,983
Disability insurance	—	—	2,799,286
Insurance	1,502,250	—	—
Inheritance, estate, and gift	1,102,980	—	—
Cigarette and tobacco	126,825	1,024,718	—
Other	316,362	354,808	61,871
Total	**$ 75,604,723**	**$ 6,418,364**	**$ 5,861,140**

NOTE 17. FUND EQUITY

A. Fund Deficits

The following funds had deficits at June 30, 2001, as shown in Table 22.

Table 22

Schedule of Fund Deficits
June 30, 2001
(amounts in thousands)

	Capital Projects Funds	Enterprise Funds	Internal Service Funds
Higher Education Construction	$ 1,715	$ —	$ —
All Other Capital Projects	4,080	—	—
Public Employees' Benefits	—	118,515	—
Water Resources Revolving	—	—	9,010
Architecture Revolving	—	—	1,307
Total	**$ 5,795**	**$ 118,515**	**$ 10,317**

B. Changes to Contributed Capital

GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, requires capital contributions to be recognized in proprietary funds and in other governmental entities that use proprietary fund accounting as revenues, not contributed capital. However, the prior period contributed capital is not to be restated until a statement is issued requiring the restatement of the prior period balances. As a result, the current year capital contributions of $64 million, $27 million, and $488,000 to enterprise funds, internal service funds, and discretely presented component units, respectively, have not increased the balance of contributed capital. The change to contributed capital is an increase of $21 million to the discretely presented component units for a prior period adjustment. The State's contributed capital accounts are shown in Table 23.

Table 23

Contributed Capital
(amounts in thousands)

	Balance June 30, 2001
Enterprise Funds	$ 296,484
Internal Service Funds	347,083
Discretely Presented Component Units	21,213
Total	**$ 664,780**

NOTE 18. RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. 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, there has been no insurance settlement in the last three years that has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered in the year in which the payment occurs by appropriations from each fund responsible for payment. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies being initially paid by SCIF. The potential amount of loss arising from risks other than workers' compensation benefits is not considered material in relation to the primary government's financial position.

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be $1.4 billion as of June 30, 2001. This estimate is based on an actuarial review of the State employee 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 service fees, industrial disability leave benefits, and incurred but not reported amounts. The estimated total liability of approximately $1.9 billion is discounted to $1.4 billion, using a 4.0% interest rate. Of the total, $153 million is included in the General Fund, $91 million in the special revenue funds, $19 million in the proprietary fund types, and $1.2 billion in the general long-term obligations account group. Changes in the claims liabilities during the year ended June 30 are shown in Table 24.

The University of California, a discretely presented component unit, is self–insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 6.25% to 7.5%. The special purpose authorities, which are discretely presented component units, do not have any significant liabilities related to self–insurance.

Table 24

Schedule of Changes in Self–Insurance Claims
Years Ended June 30
(amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	2001	**2000**	**2001**	**2000**
Unpaid claims, beginning	$ 1,091,000	$ 990,000	$ 362,300	$ 330,000
Incurred claims	617,500	361,000	247,800	241,700
Claim payments	(280,000)	(260,000)	(207,300)	(209,400)
Unpaid Claims, Ending	**$ 1,428,500**	**$ 1,091,000**	**$ 402,800**	**$ 362,300**

NOTE 19. SEGMENT INFORMATION

Selected financial information by enterprise fund activity for major segments is shown in Table 25. The primary sources of enterprise fund revenues are as follows:

Housing Loans: Interest charged on contracts of sale of properties to California veterans and to California National Guard members; loan origination fees; and interest on investments.

Water Resources: Charges to local water districts, sale of excess power to public utilities, and interest earned on investments.

School Building Aid: Interest charged on loans to school districts for acquisition, construction, or rehabilitation of classroom facilities, and income from the rental of portable classrooms to school districts.

Toll Facilities: Toll fees and interest earned on investments.

California State University: Charges to students for housing and parking; student fees for campus unions, health centers, and self-supporting educational programs; and interest earned on investments.

Leasing of Public Assets: Rental charges from the lease of public assets, and interest earned on investments.

State Lottery: The sale of lottery tickets.

Electric Power: The sale of electric power.

Public Employees' Benefits: Contributions for public employee long-term care plans, and fees for managing a deferred compensation program.

Other Enterprise: Canteen revenues and fees charged by various other departments.

Table 25

Schedule of Enterprise Fund Activity by Separate Major Segments
As of and for the Year Ended June 30, 2001
(amounts in thousands)

	Housing Loan	Water Resources	School Building Aid	Toll Facilities	California State University	Leasing of Public Assets	State Lottery	Electric Power	Public Employees' Benefits	Other Enterprise
Operating revenue	$ 242,713	$ 1,087,030	$ 25,324	$ 5,917	$ 227,442	$ 391,132	$ 2,894,842	$ 2,733,000	$ 170,021	$ 133,040
Depreciation	1,180	75,388	15,899	18,521	—	—	6,132	—	—	185
Amortization (recovery) of deferred charges	—	(98,291)	—	430	153	5,705	1,502	—	—	—
Operating income (loss)	16,995	144,908	(11,022)	(15,023)	49,909	27,133	1,005,599	83,000	(98,204)	29,697
Operating transfers in	2,219	—	—	2,401	25,612	7,108	—	—	—	4,621
Operating transfers out	2,219	—	18,122	—	35,527	1,799	—	—	—	595
Net income (loss)	15,625	(19,501)	(29,144)	(27,551)	30,101	27,301	—	—	(135,930)	178,691
Grants received	—	—	—	—	219	—	—	—	—	46,509
Grants provided	—	—	—	15,786	—	—	—	—	—	—
Property, plant, and equipment										
Additions	165	45,726	—	684	75,825	288,249	2,612	—	—	3,142
Deductions	1,180	75,388	15,899	18,521	—	—	6,158	—	—	185
Net working capital	709,278	74,344	61,077	13,454	396,046	344,941	(28,968)	4,342,000	641,993	620,797
Total assets	3,393,326	4,964,654	222,881	607,619	1,368,365	5,734,983	3,432,932	12,162,000	651,740	1,033,793
Bonds and other long-term liabilities	3,020,371	3,350,581	—	—	567,901	5,318,080	2,493,371	10,469,000	760,508	213,998
Total equity	310,860	984,344	222,653	584,845	738,154	204,581	—	—	(118,515)	796,870

NOTE 20. CONDENSED FINANCIAL STATEMENTS – DISCRETELY PRESENTED COMPONENT UNITS

Tables 26 and 27 present summary financial statements of the special purpose authorities, which are SCIF, CHFA, and non-major component units. The financial statements of the University of California, a discretely presented component unit, are presented separately in the combined statements of this report.

SCIF is a component unit created to offer insurance protection to employers at the lowest possible cost. This information is as of and for the year ended December 31, 2000. CHFA was created for the purpose of meeting the housing needs of persons and families of low and moderate income. The non-major component units provide certain services that are not part of the primary government; they also provide certain private and public entities with a low-cost source of financing for activities that are deemed to be in the public interest.

Table 26

Condensed Balance Sheet – Special Purpose Authorities – Discretely Presented Component Units

June 30, 2001

(amounts in thousands)

	State Compensation Insurance Fund	California Housing Finance Agency	Non-Major Component Units	Total
Assets				
Due from primary government	$ —	$ —	$ 17,740	$ 17,740
Other current assets	413,817	964,308	730,511	2,108,636
Investments	7,526,190	1,236,469	94,357	8,857,016
Advances and loans receivable	—	6,695,608	22,212	6,717,820
Fixed assets	205,783	—	343,566	549,349
Total Assets	**$ 8,145,790**	**$ 8,896,385**	**$ 1,208,386**	**$ 18,250,561**
Liabilities				
Other current liabilities	$ 1,139,783	$ 368,270	$ 23,107	$ 1,531,160
Benefits payable	5,563,175	—	—	5,563,175
Revenue bonds payable	—	7,688,313	138,854	7,827,167
Contracts and notes payable	—	—	9,734	9,734
Total Liabilities	**6,702,958**	**8,056,583**	**171,695**	**14,931,236**
Fund Equity				
Contributed capital	—	—	21,213	21,213
Retained earnings				
Reserved for regulatory requirements	—	737,503	—	737,503
Unreserved	1,442,832	102,299	1,015,478	2,560,609
Total Fund Equity	**1,442,832**	**839,802**	**1,036,691**	**3,319,325**
Total Liabilities and Fund Equity	**$ 8,145,790**	**$ 8,896,385**	**$ 1,208,386**	**$ 18,250,561**

Table 27

Condensed Statement of Revenues, Expenses, and Changes in Retained Earnings – Special Purpose Authorities – Discretely Presented Component Units

Year Ended June 30, 2001
(amounts in thousands)

	State Compensation Insurance Fund	California Housing Finance Agency	Non-Major Component Units	Total
Operating Revenues				
Earned premiums (net)	$ 1,759,462	$ —	$ —	$ 1,759,462
Other revenue	50,647	473,908	258,290	782,845
Total Operating Revenues	**1,810,109**	**473,908**	**258,290**	**2,542,307**
Operating Expenses				
Depreciation	2,550	229	14,360	17,139
Benefit payments	1,912,647	—	3,162	1,915,809
Interest expense	—	428,848	3,203	432,051
Amortization of deferred charges	218,044	1,470	—	219,514
Other operating expenses	127,321	65,737	147,621	340,679
Total Operating Expenses	**2,260,562**	**496,284**	**168,346**	**2,925,192**
Operating Income (Loss)	**(450,453)**	**(22,376)**	**89,944**	**(382,885)**
Nonoperating Revenues (Expenses)				
Investment and interest income (loss)	723,710	106,485	4,360	834,555
Dividends paid	(104,146)	—	—	(104,146)
Other nonoperating revenues (expenses), net	—	20,141	19,808	39,949
Net Nonoperating Revenues (Expenses)	**619,564**	**126,626**	**24,168**	**770,358**
Net Income (Loss)	**169,111**	**104,250**	**114,112**	**387,473**
Retained Earnings, July 1, 2000	**1,273,721**	**735,552**	**901,366** *	**2,910,639**
Retained Earnings, June 30, 2001	**$ 1,442,832**	**$ 839,802**	**$ 1,015,478**	**$ 3,298,112**

* Restated

NOTE 21. NO COMMITMENT DEBT

Certain debt of the special purpose authorities, which are discretely presented component units, is issued to finance activities such as construction of new facilities and remodeling of existing facilities, as well as acquisition of equipment. This debt is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, the special purpose authorities had $14.1 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by another special purpose authority, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges but that may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, the special purpose trusts had approximately $3.9 billion of debt outstanding. Like the debt of special purpose authorities, the debt of the special purpose trusts is not a debt of the State.

In addition, the State participated in transactions involving debt issued by the Bay Area Toll Authority, which is not part of the State's reporting entity. The debt was issued to finance improvements to existing bridges and to design and construct new bridges. As of June 30, the Bay Area Toll Authority had $400 million of debt outstanding, which is not a debt of the State.

NOTE 22. CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operation. To the extent they existed, the following were accrued as a liability in the financial statements: legal proceedings that were decided against the primary government before June 30, 2001; legal proceedings that were in progress as of June 30, 2001, and were settled or decided against the primary government as of November 16, 2001, and legal proceedings having a high probability of resulting in a decision against the primary government as of November 16, 2001, and for which amounts could be estimated. For governmental fund types and expendable trust funds, 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; the remainder is shown as a liability of the general long-term obligations account group. For other fund types, the entire liability is recorded in the fund involved.

In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may require it to make significant future expenditures or may impair future revenue sources. 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 involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J. B. Stringfellow, Jr., et al.*, the primary government is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. The defendants have filed a counterclaim against the primary government for alleged negligent acts resulting in significant findings of liability against the primary government as owner and operator of the site. The primary government has appealed the rulings. The court stayed the appeal pending settlement discussions. In December 1998, an interim settlement agreement was entered into between the primary government and Stringfellow defendants requiring both parties to waive all claims against each other. Finalization of this agreement is contingent upon the settlement or judgment in related actions involving the primary government and its insurance carriers, which could be held 100% liable for all clean-up costs. A trial date has not yet been set for the action against the primary government insurance carriers, but as of January 1, 2002, the primary government or the defendants in the Stringfellow action can nullify the interim agreement under certain circumstances. If either party chooses to terminate the settlement agreement, the primary government's appeal would likely be reinstated.

Estimates of the total clean-up costs for the Stringfellow site range from $500 million to $690 million. However, approximately $325 million has already been spent on clean-up by the primary government, the United States Environment Protection Agency and Stringfellow defendants. Therefore, the primary government's potential liability for the remaining clean-up costs ranges from $175 million to $365 million and from $90 million to $100 million for past clean-up costs incurred by defendants. The amount of primary government liability depends on whether the 1998 interim agreement becomes final, and on whether all or a portion of any judgment or clean-up expenses against the primary government is satisfied by recoveries from its insurance carriers.

The primary government reached a settlement agreement for a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs for special education programs for handicapped students. Under the terms of the agreement, the primary government has appropriated $270 million from its General Fund to the Superintendent of Public Instruction for allocation on a one-time basis to schools districts, county offices of education, and special education local plan areas. The agreement also requires the

primary government to appropriate $25 million each fiscal year for ten years, beginning in fiscal year 2001-02, for allocation to school districts pursuant to a prescribed calculation. However, in any year in which certain provisions of Article XVI of the California Constitution are operative, this appropriation is not required. In addition, the primary government appropriated $100 million to the Superintendent of Public Instruction to perform specific computations with respect to special education local planning areas and affected pupils and to permanently increase the amount per unit of average daily attendance for those areas.

The primary government is a defendant in three actions, *Cigarettes Cheaper!, et al., v. Board of Equalization, et al., California Assn. of Retail Tobacconists, et al., v. Board of Equalization, et al.,* and *McLane/Suneast, Inc., v. Board of Equalization*, that challenge the constitutionality of Proposition 10. The plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. The primary government filed notices of related cases. If the statute ultimately is declared unconstitutional, exposure may include the entire $750 million that is collected annually, together with interest on these collections. On November 15, 2000, the trial court ruled completely in the primary government's favor. Judgment was entered on January 9, 2001, and all three plaintiff groups filed notices of appeal on time. All parties have reached agreement on an extensive joint appendix on appeal, and opening briefs were due on November 5, 2001.

The primary government is a defendant in an action, *Ronald Arnett, et al., v. California Public Employees' Retirement System (PERS); California Board of Administration of PERS; et al.*, that challenges Section 21417 of the Government Code pertaining to industrial disability retirement benefits. The plaintiffs allege that Section 21417 makes retirement decisions based upon age, in violation of the Age Discrimination in Employment Act of 1967. In June 2001, the parties entered into a partial settlement of this action that requires further court proceedings. The primary government agreed to uncap future industrial disability retirement benefits to affected state employees. The parties also agreed that the district court would form a class of local public entity employers to resolve issues regarding the rights of PERS under state law with regard to those local public entity employers. The parties are in the process of establishing the scope of the prospective class of local public entity employers, and liability cannot be predicted at this time. An unfavorable outcome to the primary government is possible, and total damages depend upon the court's rulings on the state law class issues and the extent of retrospective relief, if any, awarded.

The primary government has prevailed in a lawsuit, *Sonoma County, et al., v. Commission on State Mandates*. This case was disclosed in the prior year's footnotes. Final judgment in favor of the primary government was entered in court records on July 18, 2001.

The primary government is party to several lawsuits and regulatory proceedings related to the Department of Water Resources (DWR) entering into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a state-wide energy supply emergency. Legislation established the Department of Water Resources Electric Power Fund (Power Fund) on January 19, 2001, and subsequent legislation expanded the powers of the fund to incur debt for the purposes of the fund and to use amounts in the fund for the purchase of power. As authorized by this legislation, the DWR began selling electricity to end-use customers of three companies, collectively referred to as the investor-owned utilities (IOUs) in January 2001. The DWR purchases power from wholesale suppliers under long-term contracts and in short-term and spot market transactions. DWR electricity is delivered to end-use customers through the transmission and distribution systems of the IOUs, and payments from the end-use customers are collected for the DWR by the IOUs pursuant to service agreements approved and/or ordered by the California Public Utilities Commission (CPUC). Legislation authorizes the DWR and the CPUC to enter into an agreement with respect to charges for the purposes of the legislation to provide for recovery by the DWR of its revenue requirements. The DWR financed its power purchases with advances from the state's General Fund, loans from financial institutions, and revenues from power sales to customers. The DWR is authorized to issue bonds in an amount not to exceed $13.4 billion and payable solely from the Power Fund and to deposit the proceeds of the bonds in the Power Fund for use for any of the Power Fund's purposes.

The lawsuits and regulatory proceedings include, among others, an IOU contesting the DWR's determination that its revenue requirement submissions to the CPUC are just and reasonable, and a CPUC filing with the Federal Energy Regulatory Commission to protest the reasonableness of long-term contracts entered into by the DWR. The CPUC has approved only interim rates for the sale of power provided by the DWR. In addition, other lawsuits and regulatory proceedings in which the primary government is a party may affect the price or supply of energy in California. In one case, the California Power Exchange Corporation (CalPX), certain IOUs, and others have brought suit against the State of California, claiming that the State's assumption of the CalPX's block forward contracts after the CalPX filed bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of $1.1 billion, which is their estimation of the fair value of

the block forward contracts at the time the DWR assumed them. Under the block forward contracts, which expire in December 2001, management estimates that the Power Fund will have paid approximately $350 million for energy provided by the contracts. These lawsuits and regulatory proceedings could impact the timing of the sale of bonds, the revenue requirements and rate structure needed to repay the debt, and the terms and conditions of the power purchase contracts. Because the legal and regulatory proceedings are in an early stage, the ultimate outcome of these matters cannot presently be determined.

The University of California and the special purpose authorities, which are discretely presented component units, are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. The outcome of such matters is either not expected to have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and other federal assistance. The primary government and the University of California 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 and the University of California may incur a liability to the federal government.

NOTE 23. PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), are included in the primary government. One retirement system, the University of California Retirement System (UCRS), is included in the discretely presented component units. The pension liability for all pension trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The amounts of the pension liability for all pension trust funds are presented on Tables 29 and 30 as the net pension obligation (NPO) as of June 30, 2001. Information on the investments of the retirement systems is included in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of

Service Award Fund (VFF). CalPERS also administers three defined contribution plans, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF), the Replacement Benefit Fund (RBF), and the Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

CalPERS uses the accrual basis of accounting. Member contributions are recorded when due except for the VFF, the SPOFF, and the RBF, which are funded only by employer contributions. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due, in accordance with the terms of each plan.

CalSTRS administers two defined benefit retirement plans within the State Teacher's Retirement Fund: the Defined Benefit Program, and the Cash Balance Benefit Program. CalSTRS also offers, through a third-party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due and the employer or the primary government has made a formal commitment to provide the contributions. Benefits are recognized when due and payable, in accordance with the retirement program.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain special purpose authorities, which are discretely presented component units, 61 school employers, and 1,350 public agencies as of June 30, 2001.

The excess of the actuarial value of assets over the actuarial accrued liability of the PERF for the primary government and other participating agencies was $26.4 billion at June 30, 2000. This is a result of the difference between the actuarial value of assets of $162.4 billion and the actuarial accrued liability of $136.0 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain special purpose authorities contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The special purpose authorities' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier miscellaneous, second-tier miscellaneous, industrial, California Highway Patrol, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2001, was approximately $11.6 billion.

All employees 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 or ten years, depending on the plan. All plans provide death, disability, and survivor benefits. The benefit provisions are established by statute.

Funding Policy: Benefits are funded by contributions from members and the primary government and by earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations or by state statute.

Employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $133 to $863. With the exception of employees in the second-tier plan, employees' required contributions vary from 5.0% to 9.0% of their salary over the base compensation amount.

The required employer contribution rates for the primary government, without group term life insurance benefits, are shown in Table 28. The employer contribution rates for employees in the industrial member and the safety member categories who are covered by group term life insurance are 0.03% and 0.006%, respectively. All other categories are not covered by group term life insurance.

Table 28

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

Year Ended June 30, 2001

	Normal Cost	Unfunded Liability	Total Rate
Miscellaneous members			
First tier	8.31 %	(8.31) %	— %
Second tier	6.60	(6.60)	—
Industrial	7.22	(7.22)	—
California Highway Patrol	13.71	—	13.71
Peace officers and firefighters	13.88	(11.15)	2.73
Other safety members	12.60	(5.80)	6.80

For the year ended June 30, 2001, the annual pension cost (APC) and the amount of contributions made by the primary government were $163 million and $173 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 29. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2000, is also shown in Table 29.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There were 59 employers participating in the JRF for the year ended June 30, 2001. The payroll for employees covered by the JRF for the year ended June 30, 2001, was approximately $150 million. The primary government pays the employer contributions for all employees covered by the JRF.

The JRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF provides death, disability, and survivor benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The required contribution rate of active plan members is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2001, the required contribution rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are pursuant to state statute. Employer contributions are required to be 8.0% of

applicable member compensation. The other funding to meet benefit payment requirements of the JRF is currently provided from the following sources: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are equal to an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year (a "pay as you go" basis).

The annual pension cost (APC) and the amount of contributions made to the JRF for the year ended June 30, 2001, were $159 million and $91 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2001, was $803 million, an increase of $68 million over last year's balance of $735 million. The APC is comprised of $162 million for the annual required contribution (ARC), $55 million for interest on the NPO, and $58 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 29. Information on the last valuation, which was performed as of June 30, 2000, is also shown in Table 29. The aggregate cost method that was used for the June 30, 2000, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 29.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2001, was approximately $53 million. The primary government pays the employer contributions for all employees covered by the JRF II.

The JRF II provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF II provides death, disability, and survivor benefits. Benefits for the JRF II are established by the Judges' Retirement System II Law.

Funding Policy: The required contribution rate of active plan members is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2001, the required contribution rate for the JRF II was 8.0%. For the year

ended June 30, 2001, the primary government's contribution rate for the JRF II was 18.13% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated primary government contribution rate is adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund.

For the year ended June 30, 2001, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $9.6 million and $9.8 million, respectively. The APC and the percentage of APC contributed for the year ended June 30, 2001, are shown in Table 29. Information on the last valuation, which was performed as of June 30, 2000, is also shown in Table 29.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for employees covered by the LRF in 2001 was approximately $3 million.

The LRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The plan provides death, disability, and survivor benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately four legislative statutory officers.

Funding Policy: The contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. For the year ended June 30, 2001, the actual contributions made by employees were approximately 1.1% of covered payroll. For the year ended June 30, 2001, the primary government's actuarially determined funding rate was 0.00% of covered payroll.

For the year ended June 30, 2001, the annual pension cost (APC) was determined to be approximately zero and the amount of contributions made by the primary government was zero as well.

The net pension obligation (NPO) of the LRF on June 30, 2001, was approximately $10.3 million, essentially the same as last year. There was no APC because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 29. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2000, is also shown in Table 29. The aggregate cost method that was used for the June 30, 2000, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 29.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 57 fire departments participating in the VFF for the year ended June 30, 2001.

The excess of the actuarial value of assets over the actuarial accrued liability of VFF was approximately zero at June 30, 2000. This is a result of the difference between the actuarial value of assets of $2.3 million and the actuarial accrued liability of $2.3 million. Contributions are actuarially determined.

F. State Peace Officers' and Firefighters' Defined Contribution Plan Fund

Plan Description: CalPERS administers the SPOFF, which is a defined contribution pension plan. The plan is a qualified money purchase pension plan under Section 401(a) of Title 26 of the Internal Revenue Code, and it is intended to supplement the retirement benefits provided by the PERF to correctional officers employed by the State of California in Bargaining Unit 6.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2001, contributions by the primary government to the SPOFF were approximately $33 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant depends only on the

amount contributed to the participant's account and on earnings on the value of the participant's account. Plan provisions are established and may be amended by statute. At June 30, 2001, there were approximately 32,400 participants.

G. State Teachers' Retirement Fund

Plan Description: CalSTRS administers the State Teachers' Retirement Fund (STRF), which includes the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program (DBS), and the Cash Balance Benefit Program (CBB Program). These programs are cost-sharing, multiple-employer defined benefit retirement plans that provide pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2001, the DB Program had approximately 1,200 contributing employers. At June 30, 2000, there were approximately 496,000 plan members, and 165,000 benefit recipients. The primary government is a non-employer contributor to the DB Program. The payroll for employees covered by the DB Program in 2001 was approximately $18.6 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program. DBS Program assets of $210 million are combined with the assets of the DB Program in the STRF.

The CBB 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. Participation in the CBB Program is optional to employers. However, if the employer elects to offer the CBB Program, each eligible employee is automatically covered unless the employee elects, within 60 days of hire or the election period determined by the employer, to participate in the DB Program or an alternative plan provided by the employer. At June 30, 2001, the CBB Program had 24 contributing school districts and approximately 12,000 contributing participants. Assets of the CBB Program of $15.8 million are combined with the assets of the DBB Program in the STRF.

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

The DB Program contribution rate of members was 8.0% of applicable member earnings through December 31, 2000. Beginning January 1, 2001, through December 31, 2011, the contribution rate of members is 6% of applicable member earnings. The employer contribution rate is 8.25% of applicable member earnings. The primary government's contribution to the system under California Education Code Section 22955, known as the Elder Full Funding Act, is 2.54% of the previous calendar year's member payroll. After the DB Program becomes fully funded, the primary government contributes only the amount necessary to help fund the normal cost of the current benefit program, unless a subsequent unfunded obligation occurs. Beginning July 1, 1999, the primary government transfers annually to the DB Program an amount equal to 1.98% of total creditable earnings of the immediately preceding calendar year to fund certain benefit enhancements that became effective January 1, 1999. Beginning October 1, 1998, there was established under Education Code Section 22955 a statutory contribution rate of 0.52%, adjustable annually in 0.25% increments up to a maximum of 1.51%, of the creditable earnings of the immediately preceding calendar year. This rate is reduced to zero if there is no unfunded obligation or normal cost deficit. As of the June 30, 2000, actuarial valuation, there was no unfunded obligation or normal cost deficit for benefits in place as of July 1, 1999.

From January 1, 2001, through January 11, 2001, the DBS Program contribution rate was 2% of applicable member earnings. There is currently no employer or primary government contribution to the program.

For the year ended June 30, 2001, the annual pension cost (APC) for the DB Program was approximately $2.0 billion, and the employer and the primary government contributions were approximately $1.9 billion and $0.5 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 29. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is also shown in Table 29.

Table 29

Actuarial Information – Pension Trusts – Primary Government
June 30, 2001

	Public Employees' Retirement	Judges' Retirement	Judges' Retirement II	Legislators' Retirement	State Teachers' Retirement Defined Benefit Program
Last actuarial valuation	June 30, 2000	June 30, 2000	June 30, 2000	June 30, 2000	June 30, 2000
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal	Aggregate Cost	Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed	None	Level % of Payroll, Open
Remaining amortization period	10 Years	None	Average of 15 Years	None	None
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value	Smoothed Market Value	Expected Value, 33.33% Adjustment to Market Value
Actuarial assumption					
Investment rate of return	8.25 %	7.50 %	7.75 %	7.50 %	8.00 %
Projected salary increase	3.75-18.38	3.75	3.75	3.75	4.25
Includes inflation at	3.50	3.50	3.50	3.50	3.50
Post retirement benefit increases	2 to 5	3.75	3.00	3.50	2.00
Annual pension costs (in millions)					
Year ended 6/30/99	$ 829	$ 134	$ 7.3	$ 0.0	$ 1,473
Year ended 6/30/00	171	136	7.5	0.0	1,150
Year ended 6/30/01	163	159	9.6	—	2,035
Percent contribution					
Year ended 6/30/99	100 %	63 %	101 %	— %	115 %
Year ended 6/30/00	100	54	100	—	183
Year ended 6/30/01	106	57	102	—	115
Net pension obligation (in millions)					
Year ended 6/30/99	$ —	$ 673.0	$ —	$ 10.7	$ —
Year ended 6/30/00	—	735.2	—	10.3	—
Year ended 6/30/01	—	803.0	—	10.6	—
Funding as of last valuation (in millions)					
Actuarial value – assets	$ 65,948	N/A	$ 40.5	N/A	$ 102,225
Actuarial accrued liabilities (AAL) – entry age	59,685	N/A	41.6	N/A	93,124
Excess of actuarial value of assets over AAL (EAV)	6,263	N/A	(1.1)	N/A	9,101
Covered payroll	11,191	N/A	43.0	N/A	18,244
Funded ratio	110.5 %	N/A	97.4 %	N/A	110 %
EAV as percent of covered payroll	56.0 %	N/A	(2.6) %	N/A	50 %

H. CalSTRS 403(b) Program

Plan Description: CalSTRS administers a 403(b) program through a third-party administrator. The 403(b) program is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a limit on the maximum amount that can be contributed annually. At June 30, 2001, the 403(b) program had approximately 378 participating employers (school districts) and 2,655 plan members.

I. Teachers' Health Benefits Fund

Plan Description: The Teachers' Health Benefits Fund (THBF) was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide postemployment health benefits to retired members of the DB Program. Beginning July 1, 2001, funds from the THBF are used to pay Medicare Part A premiums for DB Program members who are retired or will retire prior to January 1, 2006, and who meet certain other eligibility criteria.

Funding Policy: The THBF is funded as needed, from that portion of the monthly DB Program statutory employer contribution that exceeds the DB Program annual required contribution. Management believes that the current source of THBF funding will be adequate to provide for the statutory THBF benefits.

J. University of California Retirement System - Discretely Presented Component Unit

The UCRS consists of: the University of California Retirement Plan, a single-employer defined benefit plan funded with university and employee contributions; the Public Employees' Retirement System Voluntary Early Retirement Incentive Program (PERS-VERIP), a defined benefit plan for university employees who elected early retirement under the plan; and two defined contribution plans with several investment portfolios, funded with employee non-elective and elective contributions. Most university career employees participate in UCRS.

The University of California Retirement Plan provides lifetime retirement income, disability protection, death benefits and pre-retirement survivor benefits to eligible employees of the University of California and its affiliates. Membership in the retirement plan is required for all employees appointed to work at least 50% time for a year or more. Generally, an employee must have five years of service to be entitled to plan benefits. The maximum monthly benefit is 100% of the employee's highest average compensation over a 36-month period. The amount of the pension benefit is determined by salary rate, age, and years of service credit, with certain cost-of-living adjustments.

Members' contributions to the University of California Retirement Plan are accounted for separately and accrue interest at 6% annually. Upon termination, members can elect a refund of their contributions plus accumulated interest. Vested terminated

members who are eligible to retire can also elect a lump-sum payment equal to the present value of their accrued benefits. Either action results in the member's forfeiture of rights to further accrued benefits.

The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and appropriations received from the primary government.

Employees may be required to contribute to the University of California Retirement Plan. The rate of employee contributions is established annually as a percentage of covered wages, pursuant to the regents' funding policy, recommended and certified by an enrolled, independent actuary and approved by the regents, the plan's trustee. During the year ended June 30, 2001, employee contributions to the University of California Retirement Plan were redirected to the University of California Defined Contribution Plan.

In January 2001, the Board of Regents approved changes to the benefit provisions that became effective January 1, 2001, These changes increased the actuarial accrued liability by approximately $800 million.

The PERS-VERIP is a defined benefit pension plan providing lifetime supplemental retirement income and survivor benefits to members of the University of California CalPERS program (UC-PERS) who elected early retirement under provisions of the plan. The university contributed to the CalPERS program on behalf of these UC-PERS members. The cost of contributions made to the plan is borne entirely by the university and the federal Department of Energy laboratories. Over the five-year period ended June 30, 1996, the university and the Department of Energy laboratories were required to make contributions to the plan sufficient to maintain the promised benefits and the qualified status of the plan, as determined by the plan's consulting actuary.

The University of California maintains two defined contribution plans that provide savings incentives and additional retirement security for all eligible university employees. The Defined Contribution Plan (DC Plan) accepts both after-tax and pretax contributions. In addition, the university has established a Tax Deferred 403(b) Plan (403(b) Plan). There are no employer contributions to either of these two plans. Participants in the DC Plan and the 403(b) Plan may direct their elective and nonelective contributions to investment funds managed by the treasurer of the regents of the university. Participants may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis.

The DC Plan pretax contributions are fully vested and are mandatory for all employees who are members of the University of California Retirement Plan. Monthly employee contributions range from approximately 2% to 4% of covered wages, depending upon whether wages are above or below the Social Security wage base. The 403(b) Plan and the DC Plan after-tax options are generally available to all university employees. During the year ended June 30, 2001, participants contributed $377 million and $238 million to the 403(b) Plan and the DC Plan, respectively.

Table 30

Actuarial Information – University of California – Discretely Presented Component Unit

June 30, 2001

	University of California Retirement Plan	Voluntary Early Retirement Incentive Plan
Last actuarial valuation	June 30, 2001	June 30, 2001
Actuarial cost method	Entry Age Normal	Unit Credit
Amortization method	Level % of Payroll, Open	N/A
Remaining amortization period	18.2 Years	N/A
Asset valuation method	Smoothed Fair Value	Fair Value
Actuarial assumption		
Investment rate of return	7.5 %	7.5 %
Projected salary increase	4.5 to 6.5	—
Includes inflation at	4.0	4.0
Annual pension costs (in millions)		
Year ended 6/30/99	$ —	$ —
Year ended 6/30/00	—	—
Year ended 6/30/01	—	—
Percent contribution		
Year ended 6/30/99	N/A	N/A
Year ended 6/30/00	N/A	N/A
Year ended 6/30/01	N/A	N/A
Net pension obligation (in millions)		
Year ended 6/30/99	$ —	$ —
Year ended 6/30/00	—	—
Year ended 6/30/01	—	—
Funding as of last valuation (in millions)		
Actuarial value – assets	$ 40,554	$ 84.6
Actuarial accrued liabilities (AAL)	27,451	40.6
Excess of actuarial value of assets over AAL (EAV)	13,103	44.0
Covered payroll	6,539	N/A
Funded ratio	148 %	208 %
EAV as percent of covered payroll	200 %	N/A

NOTE 24. POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain special purpose authorities, which are discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an

employer. The special purpose authorities' participation in these benefits is not a material portion of the program. To be eligible for these benefits, 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. As of June 30, approximately 110,132 annuitants were enrolled to receive health benefits and approximately 89,134 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately $409 million.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 35,900 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2001, was approximately $124 million.

NOTE 25. SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2001, but prior to the date of the auditor's report.

From July 1, 2001 through November 16, 2001, the primary government issued $1.0 billion in general obligation bonds to retire previously issued commercial paper. In addition, the primary government issued $5.7 billion in revenue anticipation notes that will mature on June 28, 2002.

In April 2001, Standard and Poor's lowered its rating on California's general obligation bonds from "AA" to "A+." In May 2001, Moody's

Investors Service also lowered its rating on California's general obligation bonds, from "Aa2" to "Aa3."

Moody's placed California's general obligation bond rating under review for possible downgrade. Moody's cited increased concerns regarding the State's economically sensitive General Fund revenues and other recent developments that threaten the timely issuance of the power revenue bonds, the proceeds of which would shore up the State's projected liquidity position.

From July 1, 2001, to November 16, 2001, the Regents of the University of California issued approximately $177 million in revenue bonds, and the special purpose authorities, which are discretely presented component units, issued approximately $346 million in revenue bonds.

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Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets Over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1998	$ 52,838	$ 46,021	$ 6,817	114.8 %	$ 9,307	73.2 %
June 30, 1999	61,233	49,090	12,143	124.7	10,778	112.7
June 30, 2000	65,948	59,685	6,263	110.5	11,191	56.0

Judges' Retirement Fund II

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets Over AAL or (Unfunded Actuarial Accrued Liability) (UAAL) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll or (UAAL as a Percent of Covered Payroll) ((a - b) / c)
June 30, 1998	$ 15,120	$ 15,043	$ 77	100.5 %	$ 33,880	0.2 %
June 30, 1999	27,155	26,921	234	100.9	39,959	0.6
June 30, 2000	40,503	41,619	(1,116)	97.3	42,983	(2.6)

[1] Actuarial valuations for the Judges' Retirement Fund and the Legislators' Retirement Fund are performed using the aggregate cost valuation method. The schedule of funding progress is not required if the aggregate cost method is used.

State Teachers' Retirement Defined Benefit Program

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets Over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1998	$ 77,290	$ 74,234	$ 3,056	104.1 %	$ 15,741	19.4 %
June 30, 1999	90,001	86,349	3,652	104.2	17,185	21.3
June 30, 2000	102,225	93,124	9,101	109.8	18,224	49.9

University of California Retirement System

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability Liability (AAL) (b)	Excess of the Actuarial Value of Assets Over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1999	$ 32,087	$ 22,157	$ 9,930	144.8 %	$ 5,347	185.7 %
June 30, 2000	37,026	24,067	12,959	153.8	5,903	219.5
June 30, 2001	40,554	27,451	13,103	147.7	6,539	200.4

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press

Part II

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AUDITOR’S SECTION

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Independent Auditor's Reports on Compliance and Internal Control

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

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

The Governor and the Legislature of
the State of California

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 2001, and have issued our report thereon dated November 16, 2001. We did not audit the financial statements of certain capital projects funds, which reflect total assets and revenues, constituting 59 percent and 66 percent, respectively, of the capital projects funds. In addition, we did not audit the financial statements of certain enterprise funds, including those of the California State University, which reflect total assets and revenues, constituting 94 percent and 95 percent, respectively, of the enterprise funds. We did not audit the financial statements of certain internal service funds, which reflect total assets and revenues, constituting 22 percent and 44 percent, respectively, of the internal service funds. We also did not audit the financial statements of the pension trust funds, which reflect total assets constituting 85 percent of the fiduciary funds. Finally, we did not audit the University of California funds or the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 95 percent and 93 percent, respectively, of the component unit authorities. The financial statements of certain capital projects, enterprise and internal service funds, the pension trust funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon 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.

COMPLIANCE

As part of obtaining reasonable assurance about whether the State of California's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under *Government Auditing Standards*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the State of California's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of California's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2000-19-1 through 2000-19-11.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

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

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

November 16, 2001

CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

The Governor and the Legislature of
the State of California

COMPLIANCE

We have audited the compliance of the State of California with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. The State of California's major federal programs are identified in the summary of the auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of California's management. Our responsibility is to express an opinion on the State of California's compliance based on our audit.

The State of California's general purpose financial statements include the operations of the University of California and the California State University systems, as well as the California Housing Finance Agency, a component unit authority of the State. However, these entities are not included in the accompanying schedule of findings and questioned costs or schedule of federal assistance for the year ended June 30, 2001. The University of California and the California State University systems, and the California Housing Finance Agency, which reported expenditures of federal awards totaling $2.1 billion and $971.3 million, and $68.9 million, respectively, engaged other auditors to perform an audit in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We

believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of California's compliance with those requirements.

In our opinion, the State of California complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs. See the attachment for a list of these issues.

INTERNAL CONTROL OVER COMPLIANCE

The management of the State of California is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of California's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of California's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs. The attachment also contains a list of these issues.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions listed in the attachment is a material weakness.

SCHEDULE OF FEDERAL ASSISTANCE

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 2001, and have issued our report thereon dated November 16, 2001. We did not audit the financial statements of certain capital projects funds, which reflect total assets and revenues, constituting 59 percent and 66 percent,

respectively, of the capital projects funds. In addition, we did not audit the financial statements of certain enterprise funds, including those of the California State University, which reflect total assets and revenues, constituting 94 percent and 95 percent, respectively, of the enterprise funds. We did not audit the financial statements of certain internal service funds, which reflect total assets and revenues, constituting 22 percent and 44 percent, respectively, of the internal service funds. We also did not audit the financial statements of the pension trust funds, which reflect total assets constituting 85 percent of fiduciary funds. Finally, we did not audit the University of California funds or the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 95 percent and 93 percent, respectively, of the component unit authorities. The financial statements of certain capital projects, enterprise and internal service funds, the pension trust funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon the reports of the other auditors.

Our audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying schedule of federal assistance is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the general purpose financial statements. OMB Circular A-133 requires the schedule of federal assistance to present total expenditures for each federal assistance program. However, although the State's automated accounting system separately identifies receipts for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State presents the schedule of federal assistance on a cash receipts basis. In addition, the schedule of federal assistance does not include expenditures of federal awards received by the University of California and the California State University systems, or the California Housing Finance Agency. These expenditures are audited by other independent auditors in accordance with OMB Circular A-133. The information in the accompanying schedule has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

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

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

November 16, 2001

Attachment

ATTACHMENT

The compliance issues are:

2001-1-1	2001-9-2
2001-2-2	2001-9-6
2001-2-3	2001-12-1
2001-3-1	2001-12-2
2001-3-2	2001-12-6
2001-3-4	2001-12-7
2001-3-5	2001-13-1
2001-3-6	2001-13-2
2001-3-8	2001-13-3
2001-3-9	2001-14-1
2001-5-1	2001-14-2
2001-5-2	2001-14-3
2001-7-2	2001-14-4
2001-8-2	2001-14-5
2001-9-1	2001-14-6

The internal control over compliance issues are:

2001-2-1	2001-9-4
2001-3-3	2001-9-5
2001-3-7	2001-9-6
2001-3-8	2001-9-7
2001-7-1	2001-12-3
2001-8-1	2001-12-4
2001-8-2	2001-12-5
2001-9-2	2001-13-1
2001-9-3	2001-13-3

Schedule of Findings and Questioned Costs

STATE OF CALIFORNIA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

Summary of Auditor's Results

Financial Statements

Type of report issued by auditors	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Type of report the auditor issued on compliance for major programs	Unqualified
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	$58.6 million
Auditee qualified as low-risk auditee?	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster of Programs
	Food Stamp Cluster
	Child Nutrition Cluster
	Employment Services Cluster
	JTPA Cluster
	Highway Planning and Construction Cluster
	Student Financial Aid Cluster
	Special Education Cluster
	Aging Cluster
	Child Care Cluster
	Medicaid Cluster
10.550	Food Distribution
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
10.558	Child and Adult Care Food Program
14.239	HOME Investment Partnerships Program
17.225	Unemployment Insurance
17.253	Welfare-to-Work Grants to States and Localities
17.255	Workforce Investment Act
66.468	Capitalization Grants for Drinking Water State Revolving Fund
83.544	Public Assistance Grants
83.548	Hazard Mitigation Grant
84.010	Title I Grants to Local Educational Agencies
84.011	Migrant Education—Basic State Grant Program
84.048	Vocational Education—Basic Grants to States
84.126	Rehabilitation Services—Vocational Rehabilitation Grants to States
84.181	Special Education—Grants for Infants and Families with Disabilities
84.278	School to Career—Implementation Grants
84.340	Class Size Reduction
93.268	Immunization Grants
93.558	Temporary Assistance for Needy Families
93.563	Child Support Enforcement
93.568	Low-Income Home Energy Assistance
93.658	Foster Care—Title IV-E
93.659	Adoption Assistance
93.667	Social Services Block Grant
93.767	State Children's Insurance Program
93.917	HIV Care Formula Grants
93.959	Block Grant for Prevention and Treatment of Substance Abuse
93.994	Maternal and Child Health Services Block Grant to the States

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

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DEPARTMENT OF HEALTH SERVICES

Reference Number: 2001-19-1

CONDITION

The Department of Health Services (department) needs to strengthen its controls over the processing of loan payments. It also needs to strengthen controls on the preparation of its revolving fund financial statements. Specifically, the following concerns surfaced during our audit:

- The department did not always maintain accurate records for loan disbursements to local governments. For example, our review of loan contract files noted several instances in which the department did not record loan disbursements in the contract logs. We also noted that the department twice failed to record loan disbursements totaling $883,000 in its federal reimbursement worksheet. At the time of these disbursements, the worksheet showed the department was eligible to request an additional $73,000 in federal reimbursement; however, the amount should have been $956,000.

- The department improperly reported a liability totaling $539,000 twice in its financial statements. As a result, the amount of liabilities and expenditures reported to the State Controller's Office (SCO) was overstated by $539,000.

- The department overpaid one loan recipient $191,000. The overpayment occurred because the department erroneously paid the remaining contract funds still available even though the loan recipient had not submitted invoices for the additional amounts. The loan recipient returned the warrant shortly after it was issued. The department subsequently issued a revolving fund check for the appropriate amount.

- The department understated its interest receivable balance by $25,000 because it did not properly accrue interest for all loan disbursements. The department bills loan recipients semiannually for interest charges for the six-month periods ending December 31 and June 30. However, because the department prepared the June billings in May and did not accrue interest for five loan disbursements made subsequent to the billing date, interest owed on these five loans was not recorded in its financial statements.

- The department does not properly account for loans made from the revolving fund. In fiscal year 2000-01, the department disbursed loans totaling over $55 million. However, rather than record the disbursements as loans receivable or loans to other governments, the department expensed all payments to recipients. The department properly accounted for loan principal repayments by reducing the loans receivable balance. But because it had not previously established the loan balance, the department's financial statements reflected a negative balance in the loans receivable account.

CRITERIA

Our review of the Safe Drinking Water State Revolving Fund (revolving fund) determined that the following compliance requirements relate to the department:

The California Government Code, sections 13401 and 13403, requires state agencies to effectively maintain internal accounting and administrative controls. Such controls include accurate record-keeping procedures.

Additionally, the Department of Finance's CALSTARS Procedure Manual, Volume 3, provides uniform procedures for departments that disburse loans to other governmental agencies. Specifically, departments are required to record the disbursements in the State's Loan Principal Disbursement and Loans Receivable accounts on a budgetary basis.

RECOMMENDATIONS

The department should ensure that it records all transactions in its subsidiary records and reviews its financial statements for accuracy. Further, the department should account for loan transactions in accordance with the Department of Finance's CALSTARS Procedure Manual.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The department agrees with our finding and plans to take corrective action. The department stated that it will maintain a separate log for all loan disbursements and will cross-check the log against the federal reimbursement worksheet to ensure the proper accounting for all payments. The department will also remind staff to record payments in contract logs as soon as loans are disbursed.

The department will continue to review financial statements by utilizing the SCO checklist to assure accuracy, and will consider generally accepted accounting principles adjustments as they relate to this fund in the review process. Further, the department will identify loans disbursed after the May interest-billing date to make sure that interest is properly accrued for these loans. Finally, department staff will attend training to ensure that loan activity is accounted for in accordance with the CALSTARS Procedures Manual.

SECRETARY OF STATE

Reference Number: 2001-19-2

CONDITION

The Secretary of State's Office did not exercise adequate control over its cash account during fiscal year 1999-2000. As a result, it did not have an accurate and complete record of its cash transactions for the year. In particular, we observed the following:

- The Secretary of State's Office did not promptly remit cash receipts to the State Treasurer's Office (Treasurer's Office). For the 12 receipts we reviewed, it remitted nine items ($120,500 of $125,300) between 14 to 76 days after the date of receipt, all of which were beyond the required timelines. For the remaining three items, totaling $4,800, we were unable to calculate the number of days between receipt and remittance because the Secretary of State's Office was not able to provide the date of receipt.

- It did not prepare required monthly bank reconciliations during fiscal year 1999-2000. In addition, while it attempted to reconcile its general ledger cash balance to the State Controller's Office (Controller's Office) balance as of June 30, 2000, it could not explain a difference of $189,000. To close its books for fiscal year 1999-2000, it adjusted its cash balance to agree with the Controller's Office balance without determining the reason for the difference. During the audit, we noted that the Secretary of State's Office did not prepare monthly bank reconciliations for fiscal year 2000-01. Following the conclusion of the audit, the Secretary of State's Office informed us that it had not completed the reconciliations for each of the months of fiscal year 2000-01 until the week of July 13, 2001.

- It did not take action to cancel or send stop payment requests to the Treasurer's Office for 251 general fund checks, totaling $9,900, dated after January 1, 1999, and over one year old as of June 30, 2000, that its records indicated were outstanding. In addition, its records show a revolving fund check dated June 30, 2000, for $50,000 was outstanding for at least 10 months. Staff of the accounting unit were not aware the check had not cleared until we called it to their attention and could not explain why it had not cleared.

Unless the Secretary of State's Office maintains necessary controls over its cash, reconciles its cash balance each month, identifies reconciling items and errors appropriately, and monitors outstanding checks, it cannot ensure that cash balances are accurate or that cash assets are properly safeguarded.

CRITERIA

The State Administrative Manual, Section 8091, requires state agencies to remit to the State Treasury, regardless of the amount, all moneys determined to be revenue, reimbursements, abatements, and operating revenue within 30 days following the date collected, unless more frequent remittances are required. Further, accumulated deposits of $25,000 must be remitted as soon as possible, but not later than the first day of the week following the accumulation.

Sections 7967 and 8060 require state agencies to reconcile each month their end of month bank and centralized State Treasury System account balances.

Section 8042 states that office revolving fund and agency checks issued on or after January 1, 1998, have a one-year period of negotiability. Office revolving fund checks uncashed or unclaimed for more than one year will be canceled and the amount of such checks will be remitted to a separate account in the fund from which they were drawn. Furthermore, Section 8045 requires state agencies to send stop payment requests to the Treasurer's Office one week before the stale date of all uncashed agency checks.

RECOMMENDATIONS

We recommend that the Secretary of State's Office take the following action:

- Remit cash receipts when they reach $25,000, or at least weekly.
- Prepare monthly bank reconciliations promptly.
- Appropriately monitor and cancel all stale-dated checks.
- Consider requesting assistance from the Department of Finance's Fiscal Systems and Consulting Unit to strengthen and improve its controls over its accounting for cash.

OFFICE'S VIEW AND CORRECTIVE ACTION PLAN

The Secretary of State's Office concurs with our finding and indicates that it believes that the problems were related to its new accounting system. Specifically, it believes conversion to the new system and coding errors resulted in the $189,000 discrepancy between the Controller's Office records and the Secretary of State's Office records for which it has no documentation identifying the specific cause. Further, it states that problems with coding of revenue delayed remittances to the Treasurer's Office. Currently, it indicates that it has addressed the conditions described above by improving its reporting system, remitting cash receipts to the Treasurer's Office every other day, and reconciling its bank account monthly. Also, it reports that it is in the process of clearing or canceling stale-dated checks.

SECRETARY OF STATE

Reference Number: 2001-19-3

CONDITION

The Secretary of State's Office failed to adequately segregate duties in its accounting unit. Specifically, one employee authorized disbursements and controlled blank check forms. Two other employees prepared checks, compared checks with supporting documentation, and controlled blank check forms. Finally, another employee originated billing information, prepared invoices, maintained accounts receivable ledgers, determined accuracy of invoices, authorized adjustments, and handled disputed items. Lack of adequate segregation of duties may allow errors and irregularities to go undetected.

CRITERIA

The California Government Code, Section 13403, requires state agencies to effectively maintain internal accounting and administrative controls. Such controls include segregation of duties appropriate for proper safeguarding of state agency assets. Specifically, the State Administrative Manual (SAM), Section 8080, provides that the same person will not perform more than one of the following types of duties:

- Authorizing disbursements
- Preparing checks
- Comparing checks with authorizations and supporting documentation
- Reconciling bank accounts and posting the general ledger or any subsidiary ledger affected by cash transactions
- Initiating or preparing invoices

In addition, persons comparing checks to supporting documentation will not have access to or control blank check stock.

RECOMMENDATION

We recommend that the Secretary of State's Office appropriately segregate duties in its accounting unit to safeguard assets and ensure accurate record-keeping.

OFFICE'S VIEW AND CORRECTIVE ACTION PLAN

The Secretary of State's Office concurs with our finding. It indicates that the accounting unit has reorganized the job duties to ensure that no one person performs more than one of the duties as outlined in the SAM.

DEPARTMENT OF GENERAL SERVICES
DEPARTMENT OF DEVELOPMENTAL SERVICES

Reference Number: 2001-19-4

CONDITION

The Department of General Services (General Services) plays an important role in maintaining complete and accurate inventory records. Its Real Estate Services Division maintains the Statewide Real Property Inventory for state agencies. Similar to other agencies, it also buys and sells property that must be both recorded in the Statewide Real Property Inventory and reported to the State Controller's Office (Controller's Office). Its Office of Fiscal Services (Fiscal Services) maintains the general ledger for general fixed assets it reports to the Controller's Office. In addition, Fiscal Services is responsible for annually reconciling its records with the Statewide Real Property Inventory. If errors or inaccuracies are found, Fiscal Services is responsible for correcting its records and for informing the Real Estate Services Division of any errors in the Statewide Real Property Inventory that relate to General Services.

For fiscal year 2000-01, General Services did not ensure that adjustments that it identified to the Statewide Real Property Inventory and its general ledger were recorded on time. Specifically, although Fiscal Services conducted the annual reconciliation, it did not record adjustments to its general ledger for items it had previously identified for adjustment. In addition, although Fiscal Services informed the Real Estate Services Division of errors in the Statewide Real Property Inventory, the Real Estate Services Division did not correct the Statewide Real Property Inventory. As a result, Fiscal Services has not made adjustments of nearly $15 million in its general ledger and the Real Estate Services Division has not adjusted approximately $80 million in the Statewide Real Property Inventory. We reported a similar condition for fiscal year 1998-99. In its corrective action plan, General Services planned to annually reconcile its internal real property records to the Statewide Real Property Inventory.

Also, the Department of Developmental Services' (Developmental Services) financial services branch did not reconcile the amount reported to General Services for the Statewide Real Property Inventory with the information it reported to the State

Controller's Office (Controller's Office) in its Statement of Changes in General Fixed Assets, which is used in the State's financial statements. For fiscal year 2000-01, we reviewed the real property listing that Developmental Services maintains for the Sonoma Developmental Center (center) and compared it to the Statewide Real Property Inventory. Although Developmental Services reconciles the list of structures and improvements, the valuation amounts reported to General Services and to the Controller's Office for these properties differed. Specifically, we found that the amount for structures and improvements Developmental Services reported to the Controller's Office on the Statement of Changes in General Fixed Assets is more than $27 million greater than the amount on the Statewide Real Property Inventory.

Unless departments report complete and accurate information to the Controller's Office and General Services' Real Estate Services Division, the State's financial statements will be misstated and the Statewide Real Property Inventory will be incomplete and inaccurate.

CRITERIA

In our review of the State's General Fixed Assets, we determined that the following compliance requirements relate to General Services and Developmental Services:

The California Government Code, Section 11011.15, requires each state agency, including General Services, to furnish General Services with a record of each parcel of real property that it possesses and to update its real property holdings by July 1 of each year. It also requires General Services to maintain a complete and accurate inventory of all real property held by the State. General Services includes the departments' information in the Statewide Real Property Inventory.

Additionally, the State Administrative Manual, sections 7463, 7977, and 8660, requires agencies to report to the Controller's Office in a Statement of Changes in General Fixed Assets all additions and deductions to real property funded by governmental funds. The Controller's Office includes this information in the State's financial statements.

Further, the Department of Finance (Finance) issued directives in August 1999 and July 2000 requiring agencies to evaluate the risk of an incomplete inventory and to reconcile the amounts reported in the Statewide Real Property Inventory with the Statement of Changes in General Fixed Assets. Finance also required agencies to periodically reconcile their real property inventories to ensure the inventories are complete and accurate.

RECOMMENDATIONS

General Services should ensure that it promptly records adjustments it identifies to the Statewide Real Property Inventory and its Statement of Changes in General Fixed Assets.

Developmental Services should annually reconcile amounts it reports in the Statewide Real Property Inventory to its Statement of Changes in General Fixed Assets.

DEPARTMENTS' VIEWS AND CORRECTIVE ACTION PLANS

General Services agrees that it needs to ensure that adjustments to the Statewide Real Property Inventory and its general ledger are recorded promptly. General Services indicates it has completed posting journal entry adjustments for the fiscal year ended June 30, 2001, to the general ledger for the fixed assets account. Additionally, in March 2002, it plans to implement procedures to reconcile monthly the general ledger to the Statewide Real Property Inventory.

Developmental Services concurs with our finding and indicates that it will review the values reported by the Sonoma Developmental Center to determine the correct balance to be reflected on the Statement of Changes in General Fixed Assets it submits to the Controller's Office. Further, once this process is complete and appropriate adjustments have been made, Developmental Services will implement procedures to ensure that the annual Statewide Real Property Inventory prepared by the Sonoma Developmental Center is forwarded to Developmental Services' Developmental Center Division for review and approval of any necessary adjustments to the General Fixed Assets Account Group. Developmental Services states that the procedures implemented at the Sonoma Developmental Center will be followed at the other developmental centers in the State before the next fixed asset reporting period.

DEPARTMENT OF GENERAL SERVICES

Reference Number: 2001-19-5

CONDITION

The Department of General Services (General Services), Office of Fiscal Services, maintains the accounting and financial records for construction projects managed by General Services' Real Estate Services Division. At the end of the fiscal year, the Office of Fiscal Services reports in summary the beginning balance, additions, deductions, and ending balance of projects as "construction in progress" for inclusion in the State's financial statements.

For the fiscal year ending June 30, 2000, we reported that the Office of Fiscal Services' general ledger account for construction in progress did not reconcile with its subsidiary records. At that time, the general ledger balance was approximately $1.7 billion while a preliminary project listing totaled almost $2.1 billion, a difference of $400 million. In its corrective action plan, General Services stated that it planned to develop written procedures to reconcile its file of open projects with its construction-in-progress general ledger account. It also planned to develop procedures to identify additions and deductions to construction in progress. General Services expected to have the procedures to begin a reconciliation process completed by May 2001. Although it has developed procedures to identify additions and deductions to construction-in-progress, General Services has yet to develop procedures to reconcile its general ledger balance to its file of projects in progress. Furthermore, as of January 2002, it had only identified additions and deductions to construction in progress for one month, February 2001. Although General Services has reconciled a large amount of the difference between the general ledger balance and the preliminary project listing, there still existed a difference of over $23 million. Unless the subsidiary records support the general ledger balance, General Services has less assurance that the amounts in the State's financial statements are correct.

CRITERIA

The State Administrative Manual, Section 7900, says that the accuracy of a number of the accounting records of an agency may be proved partially by making reconciliations and verifications. Likewise, a good internal control system dictates that subsidiary records support general ledger balances.

RECOMMENDATION

To ensure proper year-end reporting of construction-in-progress balances in the State's financial statements, General Services should develop procedures to reconcile its general ledger balance with its subsidiary records. Further, it should continue to identify current-year additions and deductions to construction in progress for inclusion in the State's financial statements.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

General Services agrees with our finding and recommendation. It plans to continue identifying additions and deletions to its construction-in-progress account on a monthly basis. In addition, General Services will direct staff to develop a process to reconcile its file of active projects with the general ledger construction-in-progress account. It expects to implement this reconciliation process by July 31, 2002.

VARIOUS STATE DEPARTMENTS

Reference Number: 2001-19-6

CONDITION

State departments do not always report their employees' taxable benefits and business expense reimbursements. Federal and state tax laws require that employers report income and related tax for payments other than regular wages, including benefits and business expense reimbursements. These benefits—cash, property, or services received in addition to regular pay—are reportable as taxable income unless specifically excluded in Internal Revenue Service (IRS) regulations. Examples of such taxable reimbursements include moving and relocation expenses, mileage compensation for commuting or personal travel between home and office when employees must work overtime (overtime or callback mileage), and payment for employees' meals when they must work overtime or travel for less that 24 hours without lodging.

The State Controller's Office (Controller's Office) informs state departments through its Payroll Procedures Manual and its Payroll Letters of the IRS requirements for reporting taxable benefits and taxable business expenses. These employee benefits and business expense reimbursements must then be included in a report to the Controller's Office by the 10th of the month following the month in which the payments were made. The Controller's Office then calculates and deducts the required taxes.

Despite these requirements, some departments do not always ensure that all employees' taxable benefits or taxable business expense reimbursements are being reported to the Controller's Office. We reviewed the reporting of employee taxable benefits and reimbursements at certain state departments for fiscal year 2000-01, including approximately 115 travel expense claims at each entity to verify that employee taxable reimbursements were properly reported. However, not all of the travel expense claims we reviewed had taxable benefits claimed.

One of these state departments—the Managed Risk Medical Insurance Board (board)—did not always ensure it met the reporting requirements the Controller's Office described. The Office of Statewide Health Planning and Development processes travel expense claims for the board and on its behalf reports employees' taxable benefits and business expense reimbursements to the Controller's Office. The table shows the total number of travel expense claims with reportable items that we reviewed and the number of items not reported to the Controller's Office.

We reported similar concerns for fiscal year 1999-2000 at seven other departments. Three of these departments have established and implemented internal procedures for reporting taxable benefits to the Controller's Office. Based on our review of 167 of its travel expense claims, one of these departments—the Department of Parks and

Recreation—appears to report correctly to the Controller's Office; however, it has not yet developed written procedures to ensure that it consistently and correctly reports taxable benefits. Furthermore, as we reported in fiscal years 1998-99 and 1999-2000, the State Water Resources Control Board has not implemented any internal procedures for reporting personal use of state vehicles to the Controller's Office. Finally, while two departments—the Department of Health Services and the Department of Rehabilitation—have developed internal procedures for reporting taxable benefits, they have not accurately reported taxable benefits to the Controller's Office. The total number of travel expense claims with reportable items that we reviewed and the number of items not reported to the Controller's Office are shown in the table below.

Table

Reportable Items Reviewed That Were Not Reported to the Controller's Office in Fiscal Year 2000-01

		ITEMS NOT REPORTED	
State Agency	**Total Number of Travel Expense Claims With Reportable Items Reviewed**	**Callback Mileage**	**Meals for Less Than 24-Hour Travel/Overtime Meals**
Managed Risk Medical Insurance Board	19	5	6
Department of Health Services	14	1	4
Department of Rehabilitation	16	N/A	4
TOTALS	49	6	14

N/A: None included in travel expense claims reviewed.
Note: Some travel expense claims contained more than one type of reportable item.

When state departments do not properly report their employees' taxable benefits and business expense reimbursements, the Controller's Office cannot calculate and withhold the related tax, as required by federal and state laws and regulations.

CRITERIA

The Controller's Office Payroll and Procedures Manual, sections 120 through 170, provides procedures for reporting to the Controller's Office taxable benefits and business expense reimbursements provided to state employees. These procedures are based on federal and state tax laws. The following benefits and payments included in this manual relate to our testing of agency compliance:

- Section 130.1.2 states that reimbursement to employees for daily commuting expenses, such as for expenses from commuting or personal travel between home and office, is considered taxable income. This would include callback and overtime mileage.

- Section 143.3 states that overtime meal compensation is reportable and taxable income.
- Section 145.1.2 states that meal reimbursement for less than 24-hour travel without lodging is taxable income. Simply stated, if an employee receives reimbursement for meals during travel in which there was no overnight stay, this reimbursement is taxable income.

RECOMMENDATION

To ensure proper reporting, all state departments should ensure that they have procedures implemented to properly report taxable benefits and taxable employee business expense reimbursements. In addition, the Managed Risk Medical Insurance Board should request a copy of the report of taxable benefits that the Office of Statewide Health Planning and Development submits to the Controller's Office on its behalf to ensure that the report has been submitted.

DEPARTMENTS' VIEWS AND CORRECTIVE ACTION PLANS

The Managed Risk Medical Insurance Board (board) agrees with our finding. The board states that the Office of Statewide Health Planning and Development has corrected the errors found during the testing and provided copies of reports submitted to the Controller's Office. Also, the board indicates that the Office of Statewide Health Planning and Development has already implemented procedures and trained staff to ensure that taxable benefits and employee business expenses are reported to the Controller's Office monthly.

The Department of Parks and Recreation agrees with our finding. It indicates that it is currently developing procedures to ensure proper reporting of taxable benefits and business expenses to the Controller's Office.

The State Water Resources Control Board agrees with our finding. It states that it is in the process of establishing procedures to ensure the taxable amounts for personal use of state vehicles are reported to the Controller's Office.

The Department of Health Services agrees with our finding. The department has corrected the errors found during the testing and reported them to the Controller's Office. In addition, the department indicates it now has procedures in place for reporting of taxable benefits and has conducted training to ensure future reporting to the Controller's Office is systematic and complete.

The Department of Rehabilitation agrees with our finding. It states that it has implemented written procedures to ensure the capture and reporting of taxable benefits and reimbursements for proper reporting to the Controller's Office. Also, it indicates it has corrected its records and reported benefits and reimbursements previously overlooked to the Controller's Office.

DEPARTMENT OF PERSONNEL ADMINISTRATION

Reference Number: 2001-19-7

CONDITION

In addition to the room rate, hotel and motel operators in California charge a transient occupancy tax ranging from 6 percent to 12 percent, depending on the location. Using the state transient occupancy tax waiver form developed by the Department of Personnel Administration (Personnel Administration), a state employee may request that the hotel or motel operator waive the occupancy tax. However, as stated on the form, hotel and motel operators are advised that their participation is strictly voluntary.

State departments inform employees of the existence of the form but may not require the employees to inquire about the acceptance of the form when making reservations or checking into hotels and motels. However, departments do not have systems in place to determine whether their employees request the waiver, or if the operator grants or denies the waiver. Unless they have a system in place to ensure that employees request the tax waiver, departments may be incurring more travel expenses than are necessary.

CRITERIA

The State Administrative Manual, Section 710, states that lodging establishments may waive the transient occupancy tax if an employee shows proof that he or she is a state employee on official state business. The waiver is at the option of the lodging establishment.

RECOMMENDATION

Personnel Administration should consider alternatives for improving the use of the waiver form by state employees. For example, it should consider establishing a procedure to ensure that state employees request the waiver and that departments monitor employee use of the waiver form. In particular, Personnel Administration could modify the standard travel expense claim to include a box for state employees to check, indicating whether the employees requested the waiver. Alternatively, procedures for filing travel expense claims could be modified to require employees to include the denied waiver form with their travel expense claims indicating that they requested the waiver but it was denied. State departments could then monitor travel expense claims to ensure their employees request the waiver.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Personnel Administration concurs with the facts of the finding and has indicated that, on the next revision of the travel expense claim form, it will consider adding a box for employees to check, indicating whether the employees requested the waiver. In addition, Personnel Administration explains that it developed the exemption form in response to state departments' inquiries regarding the tax-exempt status of employees traveling on state business. Further, when it developed the tax waiver form, the State's policy extended only to making the form available and notifying state departments that they may distribute the form to their employees and that the waiver was not mandatory on the part of hotel and motel operators. In addition, Personnel Administration states that the tax waiver has never been considered a viable method of controlling or limiting lodging expenses.

DEPARTMENT OF MENTAL HEALTH
DEPARTMENT OF HEALTH SERVICES

Reference Number: 2001-19-8

CONDITION

During fiscal year 2000-01, two state departments involved in the processing of payments associated with the federal Medical Assistance Program (Medicaid) did not always minimize the number of days elapsing between the disbursement of state funds and the receipt of federal funds for reimbursement of costs incurred. As a result, the State missed opportunities to earn interest on funds that should have been in its accounts. Specifically, we estimate that the State lost about $170,000 in interest because prompt federal reimbursements were not obtained for five Medicaid claim schedules for mental health services and related administrative costs (mental health claims) totaling $60 million. For these five mental health claims, the Department of Mental Health (Mental Health) and the Department of Health Services (Health Services) took up to 36 days to process the claims and to obtain federal reimbursing funds after using State General Fund money to pay them. During fiscal year 2000-01, Mental Health and Health Services paid about $530 million in mental health claims.

CRITERIA

Sound cash management techniques require the State to take full advantage of its opportunities to earn interest on funds in its accounts by minimizing the number of days that elapse between the disbursement of state funds for federal program purposes and the receipt of federal reimbursing funds.

RECOMMENDATION

Health Services and Mental Health should jointly evaluate their cash management systems with the goal of reducing the number of days that elapse between the payment of mental health claims using State General Fund money and the receipt of federal reimbursing funds.

DEPARTMENTS' VIEW AND CORRECTIVE ACTION PLAN

Health Services is reviewing internal procedures to determine the reasons for delays in claiming federal reimbursement for Medicaid claims for mental health services. Health Services will work with Mental Health to jointly evaluate each department's cash management system, with the goal of reducing the number of days elapsed between payment of mental health claims using State General Fund money and the receipt of federal reimbursing funds.

Mental Health states that it will work with Health Services to make any changes in its current process that would allow Health Services to draw federal funds more timely.

DEPARTMENT OF HEALTH SERVICES

Reference Number: 2001-19-9

CONDITION

The Department of Health Services (department) contracts with a service provider to process and summarize electronically billions of dollars annually in claims from physicians, hospitals, pharmacies, and other health care providers under the Medi-Cal program. The contract requires the service provider to contract in turn with an independent certified public accounting (CPA) firm to perform an annual audit of general and application controls on the service provider's electronic data processing system and on its quality control efforts. This contract is subject to the department's approval, and the department specifies the functions to be audited in any given year. The purpose of the audit is to provide the department with some assurance that the service provider has systems and controls in place to ensure that it is appropriately processing the claims and accurately summarizing and reporting the financial information. The service provider's data are the basis for the payments of these claims and the reporting of the information in both the State's general purpose financial statements and in required reports to the federal government, which funds part of the payments through the Medical Assistance Program grant.

The independent CPA's report on the service provider for 2001 did not comply with contract requirements. In particular, the CPA did not follow auditing standards in executing its work or in reporting the results of its work. Auditing standards require the auditor to state explicitly what standards were followed in performing the audit work and to issue a formal report in accordance with the specified auditing standards. Instead, although the CPA's engagement letter for the work twice characterizes the planned work as an audit, the CPA has indicated informally that it followed American Institute of Certified Public Accountants consulting standards, which differ from auditing standards. Consulting services are nonattest services that involve advice or recommendations to a client. The CPA's report itself, however, has no indication of what standards the CPA followed. It also has no opinion and no clear indication, such as an authorized signature for the CPA firm or even the firm's letterhead, that the CPA firm is the author of the report. As a result, the report does not provide the department with the necessary assurances about the controls and quality assurance procedures of the service provider.

Further, given the magnitude of the transactions the service provider processes and their impact on the State's financial statements and federal reports, we believe the department should consider amending its contract with the service provider to require an audit in conformity with Statement of Auditing Standards Number 70 (SAS 70), "Service Organizations," which would report on controls placed in operation and results of tests of operating effectiveness. Such an audit would disclose whether the auditor believes the service organization's controls are suitably designed to achieve specified control objectives, whether they had been placed in operation as of a specific date, and whether the controls that were tested were operating with sufficient effectiveness to provide reasonable assurance that the related control objectives were achieved during the period specified.

CRITERIA

The contract between the department and its service provider requires that the service provider contract in turn with an independent CPA firm to perform an electronic data processing audit of general and application controls on the service provider's system for processing Medi-Cal claims and quality control efforts, with the department responsible for specifying the functions to be audited for any given period. This contract between the service provider and the CPA firm is subject to the department's approval.

Generally accepted auditing standards require that the auditor issue a formal report that specifies the standards under which the audit is conducted and that is in accordance with the specified standards.

RECOMMENDATIONS

To ensure that it is receiving the appropriate level of assurance about controls over the processing and reporting of Medi-Cal claims, the department should do the following:

- Before approving the contract between the service provider and the independent CPA firm, carefully review the contract provisions to determine that all elements of the audit requirements are properly specified, including a clear statement of which auditing standards the CPA will follow when conducting the audit.
- Review for compliance with contract provisions the engagement letter in which the independent CPA specifies, among other elements, the standards the firm will follow when conducting the audit.
- Review the audit report for compliance with contract deliverables and for all necessary elements, including a formal report in accordance with specified auditing standards on the results of the work performed and evidence of authorship of the report, such as an authorized signature of the CPA firm.

Further, the department should consider revising its contract with the service provider to specify that an audit in conformity with SAS 70, as described above, be performed.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The Department of Health Services generally agrees with our finding and recommendations and has indicated that it will incorporate our recommendations in its activities for the 2002 and subsequent audits. It has indicated that it will revise the contract to require that SAS 70 requirements, as amended, be followed for the 2002 audit. However, although it agrees that the CPA did not perform an audit, it believes that the CPA's work met the contractual requirements specifying that the scope of the work is to be determined by the department. Further, the department believes that its own monthly quality control review function and its internal audits have provided adequate oversight of the service providers' activities.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Reference Number: 2001-19-10

CONDITION

The California Department of Transportation (Caltrans) has not always maintained accurate leave balance records for its employees. For the last several years, Caltrans has been working to address its high rate of incorrect leave balances, including instances of negative balances. In response to these problems, Caltrans performed a department-wide audit to reconcile and confirm balances for all of its employees.

We reviewed the leave balances for 40 employees from the three timekeeping systems that Caltrans maintains to report daily hours worked and leave used. Caltrans uses two different automated timekeeping systems: the Time Reporting System (TRS) that includes approximately 67 percent of Caltrans' employees and the Transportation Operations and Project Support System (TOPSS), totaling another 23 percent of the employees. In addition, 10 percent of employees use a manual timekeeping system. According to its chief of the Office of Transactions Services, in fiscal years 1999-2000 and 2000-01, Caltrans transitioned to the California Leave Accounting System (CLAS) for leave balance purposes. Caltrans transfers or manually enters leave used based on the automated and manual timekeeping information systems to the CLAS. We compared the leave balances we calculated to the leave balances in the CLAS as of May 2001. Our calculations were based on available records, which were not always complete.

Of the 40 employees we reviewed, 9 had leave balance differences between the CLAS and our calculation of 20 or more hours for either sick leave or vacation. For example, one TRS employee we reviewed had a vacation balance in the CLAS of 114 hours less than we calculated. The personnel specialist could not provide an explanation for this difference. In addition, the leave hours used for two TOPSS employees we tested were not entered into the CLAS until we brought it to Caltrans' attention because the personnel specialist did not add the employees to the CLAS. These employees' leave records went unreported for 17 months and 6 months, respectively. Also, two of the seven employees reviewed on the manual timekeeping system had vacation or sick leave balance differences between the CLAS and our calculation ranging from 31 to 36 hours. For these two employees, the time sheets clearly showed that leave had been used, but the usage was not posted to the CLAS. The records for two other employees on the manual timekeeping system were so incomplete as to make calculations of approximate leave balances impossible.

The table below shows the number of employees we reviewed for each timekeeping system and the number of employees with vacation or sick leave balance differences greater than 20 hours.

Table

Leave Balances Reviewed That Had Differences of 20 or More Hours

Timekeeping System	Total Number of Employees Reviewed	Number of Employees With Vacation or Sick Leave Balance Differences of 20 or More Hours
Time Reporting System (TRS)	25	3
Transportation Operations and Project Support System (TOPSS)	8	2
Manual time sheets	7	4
TOTALS	40	9

Based on interviews with Caltrans' personnel, contributing factors for these differences include high turnover of personnel specialists, high workloads, greater risk of error from manually entering leave information for employees using manual time sheets, and problems encountered when electronically transferring data from the TRS to the CLAS. Unless Caltrans maintains and documents accurate and complete timekeeping and leave balance records, its employees may receive more or less leave compensation than they have earned.

CRITERIA

The California Government Code, Section 13401(b)(1), states that each state agency must maintain effective systems of internal accounting and administrative control as an integral part of its management practices. In addition, Section 13401(b)(2) states that each state agency will evaluate its systems of internal accounting and administrative control on an ongoing basis and, when detected, weaknesses must be promptly corrected. Finally, Section 13401(b)(3) states that all levels of management of the state agency must be involved in assessing and strengthening the systems of internal accounting and administrative control to minimize fraud, errors, abuse, and waste of government funds.

RECOMMENDATION

Caltrans should ensure that it maintains and documents accurate leave balance records.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Caltrans concurs with our finding and recommendation. It states that it is currently implementing corrective action to ensure accurate leave records are maintained in its timekeeping systems and that leave is accurately reported to and reflected in the CLAS.

DEPARTMENT OF FINANCE

Reference Number: 2001-19-11

CONDITION

The Department of Finance (Finance) does not effectively monitor variances between what departments budget and actually recover from the federal government for its share of statewide central service costs. As a result, Finance is not ensuring that the State maximizes federal reimbursement of these costs.

Of the five departments we sampled, we found that two did not receive any of the combined $55,000 in statewide central service costs that they budgeted to recover from the federal government for fiscal year 2000-01. In October 2001, Finance sent an inquiry letter to one of these departments because it had not transferred budgeted recoveries of central service costs for at least a year. In December 2001, Finance sent letters to an additional 66 state departments that did not fully recover the budgeted federal portion of central service costs for fiscal years 1996-97 through 2000-01. The two departments in our sample each responded that they were unable to bill the federal government for these central service costs because they had not developed indirect cost rate proposals.

Two additional departments in our sample did not remit to the General Fund budgeted recoveries of central service costs of $432,000 and $22,000 for fiscal year 2000-01. In its January 31, 2002, response to Finance's inquiry, one department indicated that it recovered an unspecified amount of the $432,000 in budgeted central service costs from the federal government but had not transferred those recoveries to the General Fund primarily because of cash flow and federal trust fund authority issues. As of February 7, 2002, Finance had not yet followed up with that department to determine the exact amount it had recovered from the federal government and when it planned to transfer the funds to the General Fund. The other department did not say in its January 29, 2002, response whether it had recovered central service costs for fiscal year 2000-01 from the federal government. Again, Finance has not yet followed up with that department to determine whether it recovered any central service costs from the federal government and, if so, how much and when those funds would be transferred to the General Fund.

Moreover, three of the departments in our sample also did not recover any of the combined $77,000 they budgeted to receive from the federal government for fiscal year 1999-2000. If Finance had investigated these variances more thoroughly last year, it would have known that two of these departments lacked indirect cost rate proposals and could have advised these departments to prepare indirect cost rate proposals at that time. Thus, these departments could have begun recovering the federal share of statewide central service costs sooner.

CRITERIA

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments* (OMB Circular A-87), Attachment E, Section D, requires state departments and agencies to prepare indirect cost rate proposals to recover indirect costs under federal awards. Indirect costs include the indirect costs originating in each department or agency carrying out federal awards and the costs of central governmental activities distributed through the statewide cost-allocation plan.

Additionally, the State Administrative Manual, Section 8755.1, states that each department receiving federal funds has the responsibility to file an indirect cost rate proposal with the federal government. Before submitting indirect cost rate proposals to the federal government, departments must send their proposals to Finance for review and approval.

RECOMMENDATIONS

Finance should more effectively monitor variances between budgeted and actual recoveries of the federal share of statewide central service costs. This should include prompt follow-up with departments that do not substantially recover the budgeted federal portion of these expenses. Finally, except where prohibited by federal statute, Finance should ensure that departments prepare and submit indirect cost rate proposals to facilitate the recovery of the federal share of statewide central service costs.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Finance states that it currently monitors state departments recoveries of the federal share of statewide central service costs. Finance notes that for fiscal years 1996-97 through 2000-01, average recoveries were 88.2 percent of budgeted amounts. In its annual training classes, Finance will continue to emphasize that departments prepare indirect cost rate proposals and transfer federal funds to the General Fund on a timely basis. Finance will follow-up with those state departments not preparing indirect cost rate proposals and transferring federal funds to the General Fund.

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Compliance Issue Related to All Federal Grants

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IDENTIFYING PROGRAM EXPENDITURES

Reference Number:	2001-12-7
Federal Program:	All Programs
Category of Finding:	Reporting

CRITERIA

In our review of federal reports, we determined the following were among state and federal compliance requirements:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), requires that the State prepare a schedule showing total expenditures for the year for each federal program. Further, OMB Circular A-133 requires that the State identify and audit all high-risk Type A federal programs, which are those exceeding .15 percent of total federal program moneys the State expends during the fiscal year. The California Government Code, Section 13300, assigns the Department of Finance (Finance) the responsibility for maintaining a complete accounting system to ensure that all revenues, expenditures, receipts, disbursements, resources, obligations, and property of the State are properly tracked and reported.

CONDITION

Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring a schedule showing total expenditures for each federal program. As a result, the schedule (beginning on page 127 shows total receipts, rather than expenditures, by program. Expenditure information is necessary to identify Type A programs. To ensure that we identified and audited all high-risk Type A programs, we reviewed accrual basis expenditures, which are identified manually, for all programs that we did not already plan to audit and that had cash receipts within 10 percent of the Type A program threshold. We identified three such programs. Our review of the expenditures of these programs showed that none of them exceeded the Type A threshold.

RECOMMENDATION

As priorities and resources permit, Finance should modify the State's accounting system to separately identify expenditures for all major programs.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Finance has responded that although the State, on a statewide basis, reports federal receipt totals, each individual state entity reports expenditures by grant to its federal cognizant agency. Finance states that the State's accounting system will require substantial modification to compile expenditure information to meet all federal and state requirements. Because the State has limited resources, Finance has no plans at this time to enhance the State's accounting system or to implement a new system.

Compliance and Internal Control Issues Related to Specific Grants Administered by Federal Departments

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U.S. DEPARTMENT OF AGRICULTURE

Reference Number:	2001-1-1
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 1999 7CA700CA7; 2000
Category of Finding:	Allowable Activities
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC Program) found the following compliance requirements related to allowable activities:

The Code of Federal Regulations, Title 7, Section 246.14(d), requires the prior approval from the United States Department of Agriculture's Food and Nutrition Service (FNS) for costs for automated data-processing systems. Further, under the FNS Handbook 901, Section 5000, the FNS has authorized state agencies administering the WIC Program to make data-processing acquisitions with a total project cost up to $24,999 without prior approval. For data-processing acquisitions exceeding $24,999, the WIC Program must obtain prior approval from the FNS before the expense is incurred.

CONDITION

Although it has procedures in place to ensure that it obtains prior approval from the FNS for data-processing project costs exceeding $24,999, the Department of Health Services (Health Services) does not always adhere to them. By not following FNS procurement procedures, Health Services increases the risk that the disbursement of WIC Program funds may be for unallowable purposes. For one of the two data-processing acquisitions that exceeded $24,999, Health Services failed to obtain the required FNS approval before it incurred the expenses. Specifically, Health Services acquired automated data-processing materials with a total project cost of almost $36,000 without first obtaining FNS approval for this acquisition.

RECOMMENDATION

Health Services should ensure that it follows FNS procurement procedures and obtain approval before it incurs data-processing project costs exceeding $24,999.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. It stated that it has reviewed its procurement process and will implement changes to ensure appropriate approvals are obtained prior to incurring expenses. These changes include updating the routing of procurements for authorized signatures, providing comprehensive training to all contract staff, updating procurement procedures for requests for applications and proposals, improving tracking, and ensuring follow-up is maintained.

Reference Number:	2001-2-2
Federal Catalog Number:	10.558
Federal Program Title:	Child and Adult Care Food Program
Federal Award Number and Calendar Year Awarded:	7CA300CA3; 2000
Category of Finding:	Allowable Costs and Cost Principles
State Administering Department:	Department of Education

CRITERIA

Our review of the Child and Adult Care Food Program (food program) determined that the following federal requirement relates to allowable costs and cost principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments* (OMB Circular A-87), provides the guidelines for determining allowable costs. OMB Circular A-87 states that for costs to be allowable under a federal award, costs must be necessary and reasonable for proper and efficient performance and administration of federal awards.

CONDITION

The Department of Education (Education) overpaid a food program sponsor $14,350 because it entered an incomplete claim adjustment into its claim payment system. Originally, the sponsor claimed 7,999 suppers on its initial meal reimbursement claim.

One month later, the sponsor submitted an adjustment claim showing the 7,999 meals as snacks; however, the sponsor left the suppers box on the claim form blank instead of writing in a zero. When Education entered the adjustment claim into its automated claim-processing system, it entered only the snack meal count, but did not revise the supper meal count to zero. Consequently, because Education's system does not adjust previously entered meal counts when no revised count is entered, Education did not recover the payment for the erroneously claimed suppers, resulting in a $14,350 overpayment to the sponsor.

Additionally, this overpayment increased the sponsor's average monthly reimbursement, which Education uses when calculating the allowable cash advance. As a result, Education overpaid the cash advance to the sponsor by more than $9,550. When we brought these overpayments totaling $23,900 to Education's attention, it recovered the claim and advance overpayments from the sponsor.

When Education does not have adequate procedures to prevent errors while processing adjustment claims, it risks paying sponsors incorrect amounts. Education said it would eventually have detected and taken corrective action on this overpayment when it ran its annual exception report identifying sponsors who claimed certain types of meal reimbursement that the sponsor does not normally claim. Education stated that for these unusual claims, it follows up with the sponsor to determine whether the claim is valid and takes action to recover any overpayments.

RECOMMENDATIONS

Education should improve its procedures for processing adjustment claims for the food program. Specifically, Education should improve its instructions to sponsors for completing meal-reimbursement claim forms and run exception reports more frequently to help detect inappropriate payments. Additionally, Education should instruct staff to compare the original and adjustment claims to ensure the appropriateness and completeness of the adjustment before entering the data in the system.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Education Child Nutrition Fiscal Services in their view has provided complete instructions to its sponsors detailing the procedures for filing adjustment claims when adjusting meal counts. Education has since added these instructions to the back of the reimbursement claim forms to further assist the sponsors.

Education is aware of the meal supper/supplement switch and has implemented new procedures when processing adjustment claims. Staff now pulls the original claim and compares it to the adjustment, highlighting all changes being made to the claim. When a discrepancy in the meal counts occurs, the sponsor is contacted for clarification and correction. As a second check, staff is running a monthly report of

meal counts to identify sponsors who have discrepancies in meal types claimed, specifically suppers and supplements. If a discrepancy occurs, sponsors are contacted by letter and required to submit an adjustment to correct the error.

Reference Number: 2001-5-1

Category of Finding: Eligibility

State Administering Department: Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Special Milk Program for Children and the Summer Food Service Program for Children identified the following compliance requirements related to eligibility:

The Code of Federal Regulations, Title 7, Section 215.7, requires participants in the Special Milk Program for Children to submit written applications and, upon approval, enter into a written agreement with the State administering department. Furthermore, participants who wish to serve free milk must submit a free-milk policy statement to the administering department.

Additionally, the Code of Federal Regulations, Title 7, Section 225.6, requires participants in the Summer Food Service Program for Children to submit free-meal policy statements to the administering department. Further, Section 225.14 requires Summer Food Service Program for Children sponsors to be public or nonprofit private entities.

CONDITION

The Department of Education (Education) could not demonstrate the eligibility for all participants we reviewed in the Special Milk Program for Children and Summer Food Service Program for Children. Of the 40 Child Nutrition Cluster sample items we tested, 20 related to the Special Milk Program for Children and Summer Food Service Program for Children. For these 20 sample items, Education was unable to locate the file for one of its Special Milk Program for Children sponsors. In addition, Education was unable to provide documents to show that four sponsors of the Special Milk Program for Children and one sponsor of the Summer Food Service Program for Children submitted the required free-milk or free-meal policy statements. Further, Education did not have documents in its files to verify the nonprofit status of one

Summer Food Service Program for Children sponsor. When it does not maintain complete participant files, Education cannot assure that it provides federal assistance only to eligible participants.

RECOMMENDATION

Education should ensure that it receives and retains documentation demonstrating the eligibility of all participants in the Special Milk Program for Children and the Summer Food Service Program for Children.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Education has recognized that the former filing system was inadequate and has reorganized the Nutrition Services Division (NSD) file rooms into a secured central filing system. To ensure that files are kept in the file room, NSD has established a process to ensure that all files removed from the file room must be returned within 10 working days.

During the administrative review process, NSD staff will be reviewing the program files to ensure that all required eligibility documents have been filed. Updating of documents will also take place during this time.

U.S. DEPARTMENT OF AGRICULTURE

Federal Catalog Number:	10.556
Federal Program Title:	Special Milk Program for Children
Federal Award Number and Calendar Year Awarded:	7CA300CA3; 2000

Federal Catalog Number:	10.559
Federal Program Title:	Summer Food Service Program for Children
Federal Award Number and Calendar Year Awarded:	7CA300CA3; 2000

Reference Number:	2001-13-2
Federal Catalog Number:	10.558

Federal Program Title:	Child and Adult Care Food Program
Federal Award Number and Calendar Year Awarded:	7CA300CA3; 2000
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Education

CRITERIA

Our review of the Child and Adult Care Food Program (food program) determined that the following federal requirements relate to subrecipient monitoring:

The Code of Federal Regulations, Title 7, Section 226.6(l)(1)-(3), requires states to review newly participating sponsors with five or more child care facilities or adult day care facilities within the first 90 days of operation. Further, states must review independent centers, sponsors of centers, and sponsors of day care homes with up to 200 homes at least once every four years and review sponsors of day care homes with more than 200 homes at least once every two years.

CONDITION

The Department of Education (Education) did not adequately fulfill its subrecipient monitoring responsibilities for the food program. Specifically, we reviewed seven new sponsors that Education approved to participate in the food program between July 1, 2000, and April 1, 2001, and found that Education had not conducted an administrative review for five sponsors within the first 90 days of operation. The reviews were from 5 to 11 months overdue. Education said an oversight caused these reviews to be late. When Education does not conduct timely reviews of its new sponsors, it cannot ensure that the sponsors began operations with the proper procedures in place to comply with federal food program regulations and administrative requirements.

Additionally, for its existing sponsors, Education could not locate 1 of the 40 sponsor review files that we selected to review. To validate whether Education reviewed the sponsor within the required time interval, the date of the last administrative review must be determined from the review file. However, because Education could not locate the file, we could not make this determination. When Education does not maintain adequate control over sponsor review files, it cannot demonstrate that it has reviewed sponsors within the required time interval.

RECOMMENDATIONS

Education should establish procedures to ensure it reviews all new participating sponsors with five or more sites within the first 90 days of operation. Education

should also improve its file management procedures to ensure it can locate all its sponsor review files.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

To ensure compliance with the regulatory requirement to perform an administrative review within 90-days of program implementation for each new sponsor who is approved with 5 or more sites, Education is implementing the following procedural changes:

1. It is now the responsibility of the Nutrition Services Division (NSD) Field Services Unit (FSU) to evaluate and approve all new applications. The appropriate Regional Manager will sign the approval. Upon approval, the new sponsor is added to a Nutrition Services Representative's caseload. The NSD Representative and the appropriate Regional Manager will be aware of the 90-day review requirement if the agency has 5 sites or more when approved.
2. During the approval process, the Regional Manager works with the NSD Representative to schedule the 90-day review. This scheduled date is noted on the approval checklist.
3. Education is requesting changes to the Child and Adult Care Food Program sponsor database to include posting the number of sites approved during the initial approval and the "scheduled date" for the 90-day review on the application approval log. Education is also requesting a programming change to add the scheduled 90-day review date into the review tracking system. When this is done, the FSU Manager will then receive a monthly report of scheduled reviews from these systems that will flag the up-coming 90-day reviews.
4. NSD representatives provide a monthly report to their Regional Manager on all scheduled review activities that can be used to cross-check to ensure review requirements are met.

Education Management will receive a quarterly report of administrative review activities including required 90-day reviews, dates scheduled and date conducted. This will allow Education Management to monitor review activities and take appropriate actions to ensure compliance with federal regulations.

Education consolidated its five nutrition program file rooms into one central file location and established a file clerk position as of August 2001. Education has developed new file protocols that only allow the file clerk into the file room and require Education personnel to sign for each file requested. The file clerk currently is performing file maintenance and reports weekly to division management on the process of rectifying filing errors.

Reference Number:	2001-14-1
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 1999 7CA700CA7; 2000
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC Program) found the following requirement related to special tests and provisions:

The Code of Federal Regulations, Title 7, Section 246.19(b), requires the Department of Health Services (Health Services) to conduct monitoring reviews of each local agency at least once every two years. Local agencies include public and private nonprofit health or human services agencies that provide health services, either directly or through contracts. These monitoring reviews must examine several areas of the local agency, including its financial management system. Furthermore, Health Services must have a corrective action process that includes notifying local agencies of any deficiencies found during these reviews.

CONDITION

Health Services did not ensure that the financial management systems of all local agencies were examined during monitoring reviews for fiscal years 1999-2000 and 2000-01. Nor did it always promptly notify local agencies of the deficiencies found during these reviews. As a result, Health Services cannot ensure that all local agencies are properly administering the WIC Program; at the same time, the risk that local agencies will not promptly correct deficiencies is increased.

During fiscal years 1999-2000 and 2000-01, Health Services did not ensure that the financial management systems for all 81 contracted local agencies were evaluated. To assist it in performing these evaluations, Health Services contracted with the State Controller's Office to review the financial management systems for some of the local agencies. Health Services intended to review the rest. Although Health Services and the State Controller's Office reviewed the financial management systems for a total of 67 local agencies, Health Services did not review

the remaining 14. In November 2000 Health Services revised its contract so that the State Controller's Office would review the financial management systems for half of all local agencies each year.

Further, Health Services did not always promptly notify local agencies of the deficiencies revealed during the monitoring reviews. According to program guidelines, Health Services generally issues a notification of findings (notifications) within 90 days after the program evaluation has occurred. However, of the 10 program evaluations we reviewed, Health Services failed to issue 4 notifications promptly. These notifications ranged from 15 to 64 days late.

RECOMMENDATIONS

Health Services should ensure that all areas of the monitoring reviews are examined at least once every two years. It should also promptly notify local agencies about any deficiencies noted during these reviews.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. Health Services has revised its contract with the State Controller's Office to ensure monitoring reviews of 40 to 41 providers annually. Further, Health Services has streamlined its procedures to ensure timely issuance of letters of findings to notify local agencies of deficiencies revealed during the monitoring reviews.

Reference Number:	2001-14-2
Federal Catalog Number:	10.550
Federal Program Title:	Food Distribution
Year Awarded:	State fiscal year 2000-01
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Education

CRITERIA

Our review of the Food Distribution program identified the following compliance requirement relating to special tests and provisions:

The Code of Federal Regulations, Title 7, Section 250.19(b)(iii), requires the State to conduct on-site reviews of all food processors at least once every two years (except those that are multi-state processors) with no fewer than 50 percent being reviewed each year.

CONDITION

The Department of Education (Education) did not fulfill its review responsibilities relating to its in-state food processors. During fiscal years 1999-2000 and 2000-01, Education failed to conduct on-site reviews of 9 of its 25 active in-state processors within the required two-year period. In addition, it reviewed only 24 percent of its active in-state processors during fiscal year 2000-01, rather than the required 50 percent. When it does not review in-state processors within the specified time periods, Education cannot assure that the in-state processors are meeting all Food Distribution program requirements.

RECOMMENDATIONS

Education should ensure that it reviews all in-state food processors at least once every two years. It should also review at least half of the in-state food processors that are active for the Food Distribution program each fiscal year.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

To immediately correct this compliance area, Education will review all twenty-two active in-state processors during the 2002 State Fiscal Year. Education has scheduled these reviews and is in the process of meeting this commitment.

In addition Education revised its processing review tracking system under guidance from the United States Department of Agriculture. The new system allows Education to schedule all necessary reviews, identify discontinued and multi-state processors, and monitor progress towards review closure.

Education Management will receive a quarterly report of processor review activities. This will allow Education Management to monitor compliance with the federal review requirements.

Reference Number: 2001-14-6

Federal Catalog Number: 10.561

Federal Program Title:	State Administrative Matching Grants for Food Stamp Program
Federal Award Number and Calendar Year Awarded:	7CA400CA4; 2000
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Social Services

CRITERIA

Our review of the State Administrative Matching Grants for Food Stamp Program found the following compliance requirements related to the physical inventory of food coupons:

The Code of Federal Regulations, Title 7, Section 274.1(c)(1), requires the State to conduct an on-site review of each food stamp coupon issuer and storage site at least once every three years. Section 274.1(c)(2) allows the state agency to delegate this review responsibility to another unit of state government or contract with a certified public accounting (CPA) firm.

Additionally, Section 271.2 defines *state agency* to include the "counterpart local agencies that administer such assistance programs for the state agency." This expanded definition of *state agency* allows the Department of Social Services (Social Services) to have its counterpart county agencies contract with another unit of county government or a CPA firm to have this review done.

Social Services' Food Stamp Regulations, Section 63-601.272(c), makes the county welfare departments responsible for the required physical inventory review, specifying that the review may be performed by another unit of county government or contracted with an independent CPA firm.

CONDITION

Social Services failed to ensure that all of the counties participating in the Food Stamps program obtained independent reviews. Of the 58 counties, 7 had the physical inventory review performed by their own welfare department, the same department that administers the Food Stamps program. As a result, Social Services cannot ensure that an independent review of food coupon inventories was completed for these counties. Additionally, Social Services did not require any of the counties to submit review reports for it to analyze; instead, Social Services depended on counties to self-report review findings, the date of the review, and who performed the review.

RECOMMENDATIONS

Social Services should require all county welfare departments to have the required physical inventory review performed by an independent CPA firm or another unit of county government. In addition, Social Services should require all counties to submit complete review reports to it for review.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Social Services concurs. By April 1, 2002, Social Services will send a letter to the seven noncompliant counties requesting that effective July 1, 2001, and annually thereafter, they must enlist the services of a CPA or separate county audit agency to complete an independent audit of their bulk storage food stamp coupons. In this directive, Social Services will emphasize the requisites of an independent audit and ask these counties to provide Social Services with documentation that they have procured an independent audit of their bulk storage food stamp coupons for State fiscal year (SFY) 2001-02. Social Services will request that such documentation be sent to its Food Stamp Branch no later than May 10, 2002.

In addition to the current survey that Social Services issues to the 58 counties requesting information and documentation regarding completion of their food stamp bulk storage audits, Social Services will issue an All County Information Notice (ACIN) by June 30, 2002, emphasizing each county's responsibility to obtain annual, independent audits of their bulk storage services.

Finally, Social Services will select a random sample of at least seven counties each year beginning in SFY 2001-02, and request that these counties send copies of their food stamp bulk storage audit reports to Social Services. This selection process will be discussed in the ACIN referenced above. Social Services will review and follow-up on the annual survey results and on bulk storage audit reports to ensure that counties are in compliance with federal regulations.

U.S. DEPARTMENT OF AGRICULTURE
U.S. DEPARTMENT OF LABOR
U.S. DEPARTMENT OF EDUCATION
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number: 2001-3-9

Category of Finding: Cash Management

State Administering Department: Department of Finance

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

We determined that the following requirements relate to compliance with the Cash Management Improvement Act:

The Code of Federal Regulations, Title 31, Section 205.15(a)(3)(4)(5), requires the State to submit an annual report to the U.S. Department of the Treasury accounting for the interest liabilities of the State's most recently completed fiscal year. This report must include the total federal and state interest liability for each program subject to the Cash Management Improvement Act Agreement (CMIA agreement) between the U.S. Department of the Treasury and the State, as well as the net total interest owed by the State or the federal government. Section 205.15(d) requires an authorized state official to certify the accuracy of the State's annual report.

Additionally, the CMIA agreement, Section 9.7.14, requires the State to calculate both state and federal interest liabilities on all administrative costs, including payroll and state operating costs, and to incorporate these calculations into the total interest liability information contained in the annual report.

CONDITION

The Department of Finance (Finance) requires state departments to report information related to the receipt and disbursement of federal funds of selected federal programs so that it can calculate interest liabilities under the CMIA agreement. However, we found that several departments submitted administrative cost worksheets for fiscal year 1999-2000 that included receipts or disbursements of federal funds that actually related to fiscal year 2000-01. Although Finance correctly omitted these transactions when calculating interest liabilities associated with administrative costs for fiscal year 1999-2000, it neglected to include these transactions in its fiscal year 2000-01

calculation. As a result of these omissions, Finance calculates that it overstated the State's net interest liability in the fiscal year 2000-01 annual report by nearly $1.1 million.

RECOMMENDATIONS

Finance should correct the errors contained in the State's fiscal year 2000-01 annual report by adjusting the interest liabilities of the affected programs in the fiscal year 2001-02 report. Finance should also ensure that interest liabilities contained in future annual reports are based on all receipts and disbursements of federal funds that occurred in the respective fiscal year.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Finance agrees with the finding. The overstated state interest liability will be reported and adjusted as a prior year adjustment in the fiscal year 2001-02 annual report that will be submitted to the U.S. Department of the Treasury in December 2002.

Finance states that it has implemented procedures that will accurately capture the interest liabilities for current year transactions that were reported in the previous fiscal year. Finance will also continue its ongoing efforts to reduce errors by improving internal procedures, analyzing the information reported by state departments, providing ongoing consultation and training, and annually reminding departments of their responsibilities.

U.S. DEPARTMENT OF AGRICULTURE

Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Number and Calendar Year Awarded:	7CA700CA7; 1999

U.S. DEPARTMENT OF LABOR

Federal Catalog Number:	17.207
Federal Program Title:	Employment Service
Federal Award Number and Calendar Year Awarded:	T-0620599000; 1999

Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Calendar Year Awarded:	No award number; 1999

Federal Catalog Number:	17.246
Federal Program Title:	Employment and Training Assistance—Dislocated Workers
Federal Award Number and Calendar Year Awarded:	A-7351-9-00-87-50; 1999

Federal Catalog Number:	17.250
Federal Program Title:	Job Training Partnership Act
Federal Award Number and Calendar Year Awarded:	A-7351-9-00-87-50; 1999

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Number and Calendar Year Awarded:	H126A000005; 1999

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families
Federal Award Number and Calendar Year Awarded:	G-9901CATANF; 1999

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Number and Calendar Year Awarded:	9901CA1401; 1999

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Number and Calendar Year Awarded:	9901CA1407; 1999

Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Number and Calendar Year Awarded:	05-9905CA5048; 1999

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

Reference Number: 2001-9-6

Category of Finding: Suspension and Debarment

State Administering Department: Department of Social Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs determined the following are compliance requirements related to suspension and debarment:

The Code of Federal Regulations, Title 45, Section 76.225, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Title 45, Section 76.510, requires the State to obtain certifications from participating organizations regarding debarment, suspension, ineligibility, and voluntary exclusion.

CONDITION

The Department of Social Services (Social Services) failed to require any of the counties receiving federal funds under the six federal programs we reviewed to submit the required suspension and debarment certification. Additionally, for the Adoption Assistance program, Social Services did not obtain certifications from two of the three contractors we reviewed from which Social Services contracted services totaling $100,000 or more. Without obtaining the required certifications, Social Services runs the risk of unknowingly allowing suspended or debarred parties to participate in the federal programs. For the transactions we reviewed, we used an alternative test to determine that these subrecipients were not suspended or debarred.

RECOMMENDATION

Social Services should ensure that participants in its federal programs submit the required suspension and debarment certifications before Social Services approves their participation in a federal program.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Social Services concurs. To address the requirement that it obtain "suspension and debarment certifications" from its contractors, Social Services' Contracts Bureau has implemented a procedure to obtain a "Certification Regarding Debarment,

Suspension, Ineligibility and Voluntary Exclusion-Lower Tier Transactions" for all federally funded agreements that total $100,000 or more. This requirement was made a part of the standard language contained in Exhibit D for all Social Services contracts. Additionally, Social Services has revised its contracting process to include a random review of contract files during closeout and a checklist is being developed to enable the analysts to ensure that all necessary documents have been obtained. To address the requirement that it obtain similar certifications from the 58 County Welfare Departments, Social Services' Fiscal Policy Bureau will issue a County Fiscal Letter by March 31, 2002, directing the counties to submit the required "suspension and debarment certifications" to Social Services annually, commencing with State fiscal year 2001-02.

U.S. DEPARTMENT OF AGRICULTURE

Federal Catalog Number:	10.551
Federal Program Title:	Food Stamps
Year Awarded	State fiscal year 2000-01

Federal Catalog Number:	10.561
Federal Program Title:	State Administrative Matching Grants for Food Stamp Program
Federal Award Number and Calendar Year Awarded:	7CA400CA4; 2000

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.558
Federal Program Title:	Temporary Assistance for Needy Families
Federal Award Number and Calendar Year Awarded:	G0001CATANF; 1999

Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Number and Calendar Year Awarded:	0001CA1401; 1999

Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance
Federal Award Number and Calendar Year Awarded:	0001CA1407; 1999

Federal Catalog Number:	93.667
Federal Program Title:	Social Services Block Grant
Federal Award Numbers and Calendar Years Awarded:	G-0101CASOSR; 2000 G-0001CASOSR; 1999 G-9901CASOSR; 1998

Reference Number:	2001-13-1
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Department of Health Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following compliance requirements related to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), describes the audit requirements for recipients of federal funds. Sections 200 and 320 require subrecipients spending $300,000 or more annually in federal awards to submit audit reports to the State when the reports address findings related to the federal awards that the State administers. If a subrecipient's audit report contains no findings related to the federal awards administered by the State, the subrecipient must notify the State in writing. Audit reports are due within nine months following the end of the audit period.

Further, Section 400(d) requires the State to ensure the subrecipients meet the audit requirements and issue management decisions on audit findings within six months of receiving audit reports and make sure subrecipients take appropriate and timely corrective action.

CONDITION

The Department of Health Services (Health Services) lacks an adequate system to ensure that it promptly receives all audit reports from nonprofit subrecipients required to submit them. It also lacks an adequate system to ensure that it issues management decisions on reported findings. We reviewed Health Services' subrecipient monitoring for fiscal year 2000-01 and found three programs where Health Services did not promptly receive all audit reports from nonprofit subrecipients. Specifically, Health Services' Special Supplemental Nutrition Program for Women, Infants, and Children (WIC Program) did not receive audit reports from 5 of 42 nonprofit subrecipients, and received 8 audit reports from 2 to 143 days late. Similarly, Health Services did not receive audit reports from 2 of 23 nonprofit subrecipients of the HIV Care Formula Grants program and received a program-review report rather than an audit report from another subrecipient. Additionally, for the Maternal and Child Health Services Block Grant to the States program, Health Services did not receive 10 of 25 nonprofit subrecipient audit reports, and received 3 that ranged from 10 to 108 days late. Because Health Services lacked a process to identify nonprofit subrecipients that spent $300,000 or more in federal awards, it cannot be sure that audits were even required for these subrecipients that did not submit audit reports.

Additionally, at the time of our review, Health Services had not issued the required management decisions within six months of receiving audit reports with findings for the one report with findings concerning the WIC Program in our review, and the one report with findings concerning the HIV Care Formula Grants program in our review.

Without effective systems that identify nonprofit subrecipients required to have audits and track the prompt receipt of these required audit reports, Health Services cannot ensure that its nonprofit subrecipients are meeting audit requirements and are spending program funds according to applicable laws and regulations. Furthermore, when it does not issue management decisions on audit findings affecting its programs, Health Services cannot ensure that its nonprofit subrecipients are taking prompt and appropriate action to address audit findings.

RECOMMENDATIONS

Health Services should establish procedures for identifying nonprofit subrecipients that must have an OMB Circular A-133 audit performed. Additionally, it should ensure it obtains audit reports from nonprofit subrecipients required to submit a report and should promptly issue the required management decisions on audit findings affecting its programs.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. Health Services has taken steps to include language in its contracts requiring its subrecipients to submit OMB A-133 audit reports when required and certifications when an OMB A-133 audit is not required.

Additionally, Health Services will ensure that it includes all applicable federal laws, regulations, and the provisions of the grant award in all contracts with its subrecipients. The Maternal and Child Health Branch will continue to work with programs within the Primary Care and Family Health (PCFH) Division through quarterly meetings and will establish written guidelines to coordinate the ongoing subrecipient monitoring process. In addition, the Department of Health Services' WIC Branch and the HIV Care Formula Grants program, as well as other PCFH programs, will develop a joint process to issue management decisions for all audits for its subrecipients with findings. Further, the HIV Care Formula Grants program states that it is setting up a database that will allow it to better track and follow up on late A-133 audit reports. It will then include these steps in applicable procedures manuals.

U.S. DEPARTMENT OF AGRICULTURE

Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children
Federal Award Numbers and Calendar Years Awarded:	7CA700CA7; 1999 7CA700CA7; 2000

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Calendar Years Awarded:	5X07HA00041-10; 2000 2X07HA00041-11; 2001

Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Numbers and Calendar Years Awarded:	6B04MC00336-03; 1999 6B04MC00336-04; 2000

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Reference Number:	2001-9-7
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program
Federal Award Numbers and Calendar Years Awarded:	M 93-SG 060100; 1993 M 94-SG 060100; 1994 M 95-SG 060100; 1995 M 96-SG 060100; 1996 M 97-SG 060100; 1997 M 98-SG 060100; 1998 M 99-SG 060100; 1999 M 00-SG 060100; 2000
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Housing and Community Development

CRITERIA

Our review of the HOME Investment Partnerships Program (HOME program) identified the following compliance requirements related to suspension and debarment:

The Code of Federal Regulations, Title 24, Section 24.225, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Section 24.510 requires the State to obtain signed certifications from participating organizations regarding debarment, suspension, ineligibility, and involuntary exclusion.

CONDITION

The Department of Housing and Community Development (HCD) does not require subrecipients of HOME program funds to submit suspension and debarment certifications. When HCD does not obtain the required certifications, it risks unknowingly allowing suspended or debarred parties to participate in the federal program. For the transactions we reviewed, we used an alternative test to determine that these subrecipients were not suspended or debarred.

RECOMMENDATION

HCD should establish procedures to ensure that subrecipients submit suspension and debarment certifications before approving their participation in the HOME program.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

HCD concurs with the finding. HCD notes that it currently requires subrecipients participating in the HOME program to verify that any contractors receiving HOME funds are not debarred or suspended. HCD enforces this requirement before it releases funds to subrecipients. Further, HCD has verified that all cities, counties and nonprofit housing development organizations (CHDOs) receiving HOME funds have not been debarred or suspended.

HCD states that it will now require at the time of application that all cities, counties and CHDOs certify that they are not suspended or debarred from receiving federal funds. Also, the existing language in the standard agreement requiring HOME subrecipients to certify compliance with the federal regulation will be amended to reflect that the subrecipient is not suspended or debarred.

U.S. DEPARTMENT OF LABOR
U.S. DEPARTMENT OF EDUCATION

Reference Number: 2001-2-1

Category of Finding: Allowable Costs and Cost Principles

State Administering Department: Employment Development Department

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs at the Employment Development Department (EDD) determined that the following are among the compliance requirements for allowable costs and cost principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment A, Section C(1)(b), states for costs to be allowable under federal awards, they must be allocable to federal awards under the provisions of the circular. Also, Attachment A, Section C(3)(a), states that a cost is allocable to a particular cost objective (that is, a grant) if the goods or services involved are chargeable or can be assigned to said cost objective in accordance with the relative benefits received. Finally, Attachment B, Section 11.h(5)(e), states that budget estimates or other distribution percentages determined before the services are performed do not qualify as support for personal service charges to a federal grant but may be used in the interim if the system for establishing the estimates produces reasonable approximations of the activity actually performed. Further, at least quarterly, these estimated costs should be compared with actual costs reflecting actual activity.

CONDITION

EDD lacked documentation supporting the basis of its allocation for some of its payroll and operating costs charged to federal programs. For 7 of the 30 payroll transactions we reviewed, EDD allocated the payroll costs to federal programs based on estimates of the time staff spent administering the various federal programs instead of using actual time worked. EDD also allocated 5 of 10 operating costs we reviewed among various federal programs that were based on similar estimates. Although EDD indicated that it based the percentages it used to allocate the payroll and operating costs on a workload analysis, it could not provide us with this analysis.

Furthermore, EDD could not demonstrate that it revised the percentages quarterly to reflect more current circumstances, nor could it show it adjusted charges to federal programs to reflect actual activity. As a result of EDD's inability to support the basis of

its allocations, we could not determine whether EDD appropriately allocated 7 payroll transactions and 5 operating costs totaling approximately $125,000 among various state and federal programs. We were unable to determine the full impact of this issue because EDD was unable to provide us with the total amount it allocated using estimates for fiscal year 2000-01.

We reported a similar finding in our audit for fiscal years 1998-99 and 1999-2000. According to EDD, it has since reviewed the allocation codes and is working toward eliminating unnecessary codes. Furthermore, it has developed and disbursed general guidelines for staff to follow when establishing and documenting allocation codes. EDD plans to fully implement the guidelines and develop documentation for all allocation codes during fiscal year 2001-02.

RECOMMENDATION

To ensure that charges to federal programs are appropriate, EDD should develop an allocation process that bases charges on actual hours worked. When EDD allocates costs using estimates, it should ensure that the bases of the estimates are supported by the appropriate analyses, that the estimates are revised at least quarterly to reflect necessary changes, and that the costs charged to the federal awards are adjusted to reflect the actual activity performed.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

EDD concurs with the finding and states that, as of July 1, 2001, it has implemented a new allocation code process. According to EDD, the new process established guidelines that should satisfy federal requirements. In addition, EDD indicates that use of allocation codes is more restrictive and it is requiring staff to justify, document, and perform annual reviews of the allocation codes it continues to use.

U.S. DEPARTMENT OF LABOR

Federal Catalog Number:	17.207
Federal Program Title:	Employment Service
Federal Award Number and Calendar Year Awarded:	ES-10662-00-55; 2000

Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Calendar Year Awarded:	UI-10924-00-55; 2000

Federal Catalog Number:	17.255
Federal Program Title:	Workforce Investment Act
Federal Award Number and Calendar Year Awarded:	AA-10295-00-50; 2000

Federal Catalog Number:	17.801
Federal Program Title:	Disabled Veterans' Outreach Program
Federal Award Number and Calendar Year Awarded:	E-9-5-1-5085; 2000

Federal Catalog Number:	17.804
Federal Program Title:	Local Veterans' Employment Representative Program
Federal Award Number and Calendar Year Awarded:	E-9-5-1-5085; 2000

Federal Catalog Number:	17.253
Federal Program Title:	Welfare-to-Work Grants to States and Localities
Federal Award Numbers and Calendar Years Awarded:	Y-6566-8-00-81-50; 1998; Y-7432-9-00-81-50; 1999

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.278
Federal Program Title:	School-to-Work State Implementation Grants
Federal Award Number and Calendar Year Awarded:	V278E70020; 2000

U.S. DEPARTMENT OF TRANSPORTATION

Reference Number:	2001-9-1
Federal Catalog Number:	20.205
Federal Program Title:	Highway Planning and Construction
Federal Award Number and Calendar Year Awarded:	N 4520.162; 2000
Category of Finding:	Procurement, Suspension and Debarment, Special Tests and Provisions
State Administering Department:	Department of Transportation

CRITERIA

Our review of the Highway Planning and Construction program identified the following compliance requirement:

The Code of Federal Regulations, Title 49, Section 18.42, in part, requires the State to retain all financial and programmatic records, supporting documents, statistical records, and other records and documents considered as pertinent to program regulations or the grant agreement for a three year period starting on the day the grantee, which is the State, submits its final expenditure report to the U.S. Department of Transportation, Federal Highway Administration (FHWA).

CONDITION

The California Department of Transportation (Caltrans) could not always locate its contract files or other documents needed to show that it complied with certain federal requirements for its highway construction projects. More specifically, of 40 contracts we selected to test, Caltrans could not locate the contract file for 5 contracts, and the contract files for another 12 were incomplete. The awards for these 17 contracts totaled more than $1.1 billion. As a result, we could not test whether Caltrans obtained the appropriate FHWA and state approvals for 14 contracts, obtained from contractors the required suspension or debarment certifications for 10 contracts, used the appropriate competitive process for 10 contracts, or obtained FHWA approval of major contract change orders for 9 contracts. Furthermore, for the one major contract change order we were able to test, Caltrans could not locate the document that showed it obtained FHWA's written approval before proceeding with the related construction, although Caltrans indicated it had received verbal approval. This change order increased the amount of the contract by more than $367,000 and added 22 working days to the contract's length. Finally, we could not ensure that one of

Caltrans' district offices performed quality assurance testing on materials and workmanship it used for 2 of 10 construction projects we tested, because it could not locate the supporting documents. As a result, we cannot conclude that Caltrans fulfilled its responsibilities related to these compliance requirements. In addition, when Caltrans does not properly maintain documents that demonstrate its compliance with federal requirements for its highway construction projects, it runs the risk of incurring costs that FHWA may not reimburse.

RECOMMENDATIONS

Caltrans should improve its system of tracking contract files and other documents for its highway construction projects as well as ensure that the contract files are complete.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Caltrans agrees with the finding and states that staffing issues, a lack of procedures, and inadequate file space caused the condition. According to Caltrans, it has resolved the staffing issue and is working towards obtaining adequate space for the contract files by December 2002. In addition, Caltrans states that it will complete a comprehensive business process review of the filing system and train its staff on the improved procedures resulting from the review by June 2002.

Regarding the lack of written FHWA approval of contract change orders, Caltrans states that it recently clarified the section of its Construction Manual that describes the approval process. Caltrans is also developing a course on contract change orders which is intended to provide instruction on the requirements for FHWA approval. This course will begin in February 2002 and will target Caltrans' Resident Engineers.

Finally, in July 2001, Caltrans began training district field office staff on "Field Office Procedures for Statewide Consistency" to improve controls over its records of testing materials and workmanship.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Reference Number:	2001-8-1
Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2000-01
Category of Finding:	Period of Availability
State Administering Department:	Office of Emergency Services

CRITERIA

Our review of the Public Assistance Grants program determined that the following compliance requirement relates to period of availability:

The Code of Federal Regulations, Title 44, sections 206.204(c) and (d), establishes time limits for completing the various types of work funded through the Public Assistance Grants program.

CONDITION

The Office of Emergency Services (Emergency Services) cannot ensure that the services it is paying for are within the allowable time period. Emergency Services makes payments to its subrecipients after the subrecipients submit a payment-request document. However, these forms do not include the time period during which the services being reimbursed occurred. Most of the 40 payments we reviewed were requested while the project was in progress, providing some assurance that the related services were rendered during the period of availability. However, 4 payments totaling more than $950,000 were requested after the approved project completion date. Thus, we had no such assurance. For example, Emergency Services paid one recipient more than $652,000 in September 2000—even though the latest time extension for the project had expired six months earlier in April 2000. When Emergency Services does not ensure that work being claimed by its subrecipients occurred within approved time frames, it runs the risk of payments being disallowed by the federal government.

RECOMMENDATION

Emergency Services should require its subrecipients to provide sufficient information on their payment requests to allow it to determine if the services being reimbursed were completed within the allowable time periods. If payment requests are for services that were not provided within the approved time periods, Emergency Services should not approve the payment.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Emergency Services (OES) agrees that current payment processes are not sufficient to determine if subrecipient reimbursement requests are for services provided within approved time periods. However, OES disagrees that the auditor's recommendation will reduce the risk of inappropriate payments to subrecipients. Instead, OES has initiated a comprehensive review of its disaster assistance grant management system to identify areas for improvement, including linking grant payment processes with on-going grant monitoring processes. OES anticipates implementing changes to its current grant management system for open and material grants during fiscal year 2002-03.

Reference Number:	2001-9-5
Category of Finding:	Suspension and Debarment
State Administering Department:	Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirements relate to suspension and debarment:

The Code of Federal Regulations, Title 44, Section 17.225(a), requires the Office of Emergency Services (Emergency Services) to ensure that it does not make sub-awards to any parties who are debarred, suspended, or otherwise excluded from participation in federal assistance programs. Additionally, Section 17.510(b), requires Emergency Services to obtain certifications that affirm participating parties are not presently debarred or suspended.

CONDITION

Emergency Services did not require Public Assistance Grants and Hazard Mitigation Grant program applicants to submit suspension and debarment certifications. When it does not require these certifications, Emergency Services runs the risk of allowing suspended or debarred parties to participate in the federal programs.

Emergency Services' position is that although it recognizes that federal regulations prohibit it from making sub-awards to suspended, debarred, or otherwise ineligible parties, it believes another federal regulation excludes all transactions for the Public Assistance Grants and Hazard Mitigation Grant programs from the requirement to submit suspension and debarment certifications. This regulation, the Code of Federal Regulations, Title 44, Section 17.110(a)(2)(v), states that one of the exceptions for coverage under the suspension and debarment regulations is "transactions pursuant to national or agency-recognized emergencies or disasters." During our fiscal year 1999-2000 review of these federal programs, we contacted the Federal Emergency Management Agency's (FEMA) legal staff for an interpretation of how this regulation applies. The legal staff indicated that suspension and debarment requirements do not apply to the initial response to a disaster, but would apply to the later recovery transactions.

RECOMMENDATIONS

Emergency Services should obtain written clarification from FEMA as to whether it must obtain suspension and debarment certifications from its subrecipients for the Public Assistance Grants and Hazard Mitigation Grant programs. If FEMA requires it to obtain these certifications, Emergency Services should ensure that it does so before it approves applications for federal program funds.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Emergency Services disagrees with this finding and with the verbal interpretation given by FEMA counsel. Emergency Services' position is that Public Assistance and Hazard Mitigation subrecipients are exempt from the requirement to submit the suspension and debarment certification identified in the Code of Federal Regulations, Title 44, Section 17.

FEMA's Office of Inspector General recently completed an audit of Emergency Services' management of the Public Assistance and Hazard Mitigation programs. The audit scope included a review of both program and financial-related activities for 18 disasters declared from 1983 through 1999. The draft report, issued in August 2001, made no mention of any deficiency in this area, therefore, no further clarification is needed from FEMA.

Emergency Services agrees that subrecipients, in accordance with the Code of Federal Regulations, Title 44, Section 13.35, should not enter into agreements with any parties who are debarred, suspended, or otherwise excluded from participation in federal assistance programs. Current subrecipient monitoring processes include periodic reviews for compliance with Section 13.35. Emergency Services is in the process of developing a Grant Management system which will establish a more routine review to ensure that subrecipients have complied with applicable grant laws and regulations.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2000-01

Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2000-01

Reference Number:	2001-12-4
Category of Finding:	Reporting
State Administering Department:	Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirements relate to reporting:

The Code of Federal Regulations, Title 44, Section 13.20, requires the State to maintain accounting records to properly track and accurately report financial activities related to federal grants. Additionally, Section 13.41(b), requires the State to use the financial status report form to report the status of funds for all nonconstruction grants. To meet this requirement for both the Public Assistance Grants and Hazard Mitigation Grant programs, the Federal Emergency Management Agency (FEMA) requires the

Office of Emergency Services (Emergency Services) to submit quarterly financial status reports for each disaster. FEMA mandates that the status reports are to include total federal expenditures, including administrative allowances, and total recipient expenditures, excluding amounts for administration.

CONDITION

Emergency Services' financial status reports contain unsupported expenditure information. As a result, FEMA cannot rely on these reports to accurately assess program status. Rather than basing its and the subrecipients' share of expenditures on information from its accounting records, Emergency Services inappropriately uses a formula to derive this amount. Emergency Services uses this formula because it does not completely track expenditure information from subrecipients. Emergency Services' use of formulas can also result in errors. For example, in one report we tested, Emergency Services inappropriately included $36,722 in administrative costs in its reported recipient expenditures. To report recipient expenditures, Emergency Services uses its federal expenditures to derive its state and local expenditure amounts. However, although federal guidelines require Emergency Services to include administrative costs when reporting federal expenditures, it should exclude administrative costs when reporting state and local expenditures.

Additionally, Emergency Services does not separately account for the amount of state funds it expends administering these two federal programs. As a result, even if it did use its accounting records for reporting expenditure information, Emergency Services could not assure the accuracy of the amount of administrative expenditures that it reported to the federal government.

RECOMMENDATIONS

Emergency Services should ensure that its accounting records support its financial status reports. Additionally, it should separately account for and report on state administrative costs expended on federal disasters and subrecipient expenditures.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Before January 1999, FEMA required financial status reports to be filed upon closure of disasters, after final inspection and financial reconciliation of all subgrantee records. FEMA notified Emergency Services in January 1999 that financial status reports would be required on a quarterly basis for all disasters. Emergency Services has made several attempts to discuss with FEMA how best to report California disaster activity, which currently involve more than 35,000 individual projects, into a single, generic federal report format. In addition, Emergency Services has requested guidance on how to report the timing differences between expenditures and fund disbursements that are associated with federal regulatory requirements placed on the State. For example, in any given disaster as much as 30 percent of the disaster funds

can be associated with small projects. In accordance with federal regulations, disaster funds for small projects are advanced to subgrantees at the time of approval; thus, disbursement occurs prior to any actual expenditures being incurred. Consequently, a quarterly report of on-going disaster activity will have some portion of federal disbursements without associated expenditures. Emergency Services will continue to seek an active dialogue with FEMA to reach consensus on how to report on-going disaster assistance activity without creating a burdensome workload.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2000-01

Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2000-01

Reference Number:	2001-12-5
Category of Finding:	Reporting
State Administering Department:	Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirement relates to reporting:

The Code of Federal Regulations, Title 44, Section 13.20, requires the State to maintain accounting records to properly track and accurately report financial activities related to federal grants.

CONDITION

In fiscal year 2000-01, the Office of Emergency Services (Emergency Services) did not reconcile the receipts and disbursements reported in its federal cash transaction reports to its official accounting records. As a result, we could not determine whether the receipts and disbursements reported in the quarterly federal cash transaction reports agreed with Emergency Services' accounting records.

RECOMMENDATION

Emergency Services should reconcile the receipts and disbursements reported in its federal cash transaction reports to the receipts and disbursements recorded in its accounting records.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Increased workloads and the inability to obtain additional positions to hire qualified staff with the level of expertise to perform these functions have been a mitigating factor currently and in the past. Emergency Services plans to continuing pursuing requests for additional staffing in order to comply with the recommendation.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2000-01

Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2000-01

Reference Number:	2001-13-3
Category of Finding:	Subrecipient Monitoring
State Administering Department:	Office of Emergency Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Public Assistance Grants and Hazard Mitigation Grant programs determined that the following compliance requirements relate to subrecipient monitoring:

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133), requires subrecipients spending more than $300,000 in federal assistance to submit audit reports to the State within nine months of the end of their fiscal year. If an audit finds that a subrecipient has failed to comply with federal program requirements, OMB Circular A-133 also requires the State to issue a management decision regarding the resolution of the audit finding within six months of receiving the audit report and ensure that the subrecipient proceeds with corrective action as rapidly as possible.

CONDITION

During fiscal year 2000-01, the Office of Emergency Services (Emergency Services) did not have a system in place to ensure that its nonprofit subrecipients spending more than $300,000 in federal funds submitted required audit reports. Emergency Services said it previously contracted with the State Controller's Office to fulfill these responsibilities. However, Emergency Services did not renew its contract with the State Controller's Office for these services for audits of fiscal years after 1998-99, and it has since failed to complete these responsibilities itself. As a result, Emergency Services has no assurance that its nonprofit subrecipients spending more than $300,000 complied with applicable federal requirements. During fiscal year 1999-2000 (for which applicable audit reports would have been due to the State during fiscal year 2000-01), Emergency Services paid more than $1.4 billion in federal funds to 27 nonprofit subrecipients.

Additionally, for the audit reports of its local government subrecipients, Emergency Services did not ensure that a management decision regarding the resolution of audit findings was made within six months after it received an audit report. During fiscal year 2000-01, the State Controller's Office reviewed the annual audit reports of local governmental agencies receiving more than $300,000 and forwarded three reports containing seven findings to Emergency Services for resolution. According to Emergency Services, it did not receive two of the reports, which represent four of the seven findings and, therefore, did not take any action to resolve the findings. For the remaining report, representing three findings, Emergency Services stated it had followed up and resolved the subrecipient's audit findings. However, it did not issue written management decisions that clearly state whether the audit findings were sustained, the reasons for its decisions, and the actions it expected the auditee to take to resolve the audit findings.

RECOMMENDATIONS

Emergency Services should establish controls to ensure that private, nonprofit subrecipients receiving more than $300,000 in federal grant funds are audited annually. Additionally, Emergency Services should promptly follow up on all reported audit findings concerning subrecipients, and ensure that written management decisions regarding the resolution of audit findings are issued within six months of its receipt of the subrecipients' audit report.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Emergency Services agrees with the recommendation and has taken corrective action. In November 2000, Emergency Services formed a new unit whose responsibilities include ensuring that subrecipients meet the audit requirements of OMB Circular A-133. Additionally, this unit will promptly follow up on all reported audit findings concerning subrecipients, and ensure that written management decisions regarding the resolution of audit findings are issued within six months of its receipt of the subrecipients' audit report.

FEDERAL EMERGENCY MANAGEMENT AGENCY

Federal Catalog Number:	83.544
Federal Program Title:	Public Assistance Grants
Year Awarded:	State fiscal year 2000-01

Federal Catalog Number:	83.548
Federal Program Title:	Hazard Mitigation Grant
Year Awarded:	State fiscal year 2000-01

U.S. DEPARTMENT OF EDUCATION

Reference Number:	2001-2-3
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A000005; 2000
Category of Finding:	Allowable Costs and Cost Principles
State Administering Department:	Department of Education

CRITERIA

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) identified the following compliance requirement related to allowable costs and cost principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments* (OMB Circular A-87), Attachment A, Section (C), states that for costs to be allowable under a federal award, costs must be necessary and reasonable for the proper and efficient performance and administration of federal awards.

CONDITION

The Department of Education (Education) did not always determine the cost-effectiveness of the State's use of Migrant Education funds. Education paid one subrecipient more than $29,000 in overhead costs to administer a contract that Education should more appropriately administer. Specifically, Education allocates Migrant Education funds to 22 migrant education regional offices statewide. In addition, because the U.S. Department of Education requires Education to report the number of migrant children in California eligible for the program, the 22 regional offices enter data regarding eligible migrant children into a computer system.

The data are transmitted to a vendor who combines the data from all the regional offices, ensures that migrant children are not counted more than once, and calculates the number of eligible migrant children in California. Although Education administers the contract with this vendor, Education pays one regional office to administer a contract with another vendor that provides software and technical assistance to the statewide regional offices for the development and entry of their

count data. The vendor services appear to be an appropriate use of Migrant Education funds. However, Education should more appropriately administer this contract because it is for assistance to the regional offices statewide, and not just for the one regional office. As a result, the additional $29,000 in overhead costs that Education paid the one region for its administration of the contract may not be necessary for the proper and efficient performance and administration of the program. According to Education, it is seeking to enter into a sole-source contract with the vendor and is nearing the final stages of the process at which point it will begin administering the contract. However, during fiscal year 2000-01, the regional office continued to administer the contract.

Education also approved the use of $85,850 in Migrant Education funds without determining whether the use was reasonable as required by OMB Circular A-87. Education used the funds to pay for vehicle leases, insurance, and maintenance in two regional offices and for a vehicle purchase in a third regional office. However, Education did not follow its own policy, which requires it to approve vehicle leases or purchases only if program subrecipients can show it is more cost-effective to lease or purchase vehicles than to reimburse individuals who drive their personal vehicles on Migrant Education business. When Education approves the use of Migrant Education funds without assessing the cost-effectiveness of the regional offices' proposed use of these funds, it cannot assure the efficient and effective use of federal program funds.

RECOMMENDATIONS

Education should continue its efforts to take on the contract administration responsibilities for the software and technical assistance contract. In addition, Education should ensure that it approves only allowable costs that are reasonable and necessary to perform the program. It should also follow its program policy for the approval of vehicle leases or purchases.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Administration of the Contract: The region that temporarily contracted with the Tromik Technology Corporation (for services to the 22 migrant education regions) had some overhead costs for administering this contract. Tromik continues to provide technical assistance to the 22 migrant education regions. Migrant Education is currently in the process of obtaining the services of Tromik through a sole-source contract. The proposed sole-source contract period is January 1, 2002, through December 31, 2002.

Leases: As a result of the fiscal year 2000-2001 findings, Migrant Education has developed a Cost Analysis Worksheet for migrant education regions. Regions use this form (or may use their own format) to show the reasonableness of costs associated with leases and/or purchases of vehicles. A region will show that it is more cost effective to lease or purchase vehicles rather than to reimburse individuals on a

daily basis prior to entering into a future lease/purchase contract. The submittal of this information was required with their regional applications for fiscal year 2001-2002. If the analysis showed that it is not cost effective, Migrant Education informed the region to terminate the lease/purchase contract as soon as legally feasible. The regions will maintain a complete analysis worksheet on file for all vehicle lease/purchase contracts approved by Education/Migrant Education.

Reference Number:	2001-3-2
Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities
Federal Award Number and Calendar Year Awarded:	H181A000037; 2000
Category of Finding:	Cash Management
State Administering Department:	Department of Developmental Services

CRITERIA

Our review of the Special Education—Grants for Infants and Families with Disabilities program (Early Intervention) identified the following compliance requirements relating to cash management:

The Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for programs not covered in the Cash Management Improvement Act agreement between the U.S. Department of the Treasury and the State. Section 205.20 of this subpart requires the State to limit the cash advances from the U.S. Department of the Treasury to the minimum amounts needed and to time the advances, as close as it can, with the actual and immediate cash needs of the State to carry out the program.

CONDITION

The Department of Developmental Services (Developmental Services) did not always minimize the amount of time elapsing between the transfer of Early Intervention federal funds to the State and their disbursement for program costs. Specifically, the time between the receipt of federal funds and the issuance of warrants in 29 of 36 transactions ranged from 5 to 58 days. For 12 of those transactions, the elapsed time was 10 days or more. When Developmental Services

does not minimize the amount of time between the receipt and disbursement of federal funds, the State improperly earns interest while federal funds are held in State accounts. For the 29 transactions, we estimate that the State earned about $16,500 in interest.

RECOMMENDATION

To minimize the time elapsing between the receipt and disbursement of federal funds, Developmental Services should request federal funds closer to the date warrants for program costs are released.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Developmental Services acknowledges that the time between receipt and disbursement of federal funds was not always minimized. Further, it states that it has current procedures to minimize the risk of having federal funds in hand for too long a period before disbursements are made. However, Developmental Services notes that despite stamping payment requests as "federal fund expenditures," a possible cause for the delays may be its no longer using special expedite tags for the requests. Developmental Services states that it will discuss this problem with the State Controller's Office to determine what steps can be taken to assure that these types of payment delays do not occur in the future and will implement additional cash monitoring procedures for any federal funds.

Reference Number:	2001-3-3
Category of Finding:	Cash Management
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows a state's subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires a state's subrecipients to promptly pay to the federal agency any interest greater than $100 that they earned on the advances. Additionally, if a

state's subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

CONDITION

The Department of Education (Education) does not have adequate procedures to ensure that program subrecipients minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, Education disburses predetermined percentages of program funds to subrecipients rather than assessing and disbursing funds based on each subrecipient's immediate cash needs. Further, Education does not always require subrecipients to report on their use of program advances before making additional payments to the subrecipients. Combining Education's inadequate procedures to assess each subrecipient's cash needs with its predetermined advance-payment process does not ensure that subrecipients minimize the time elapsing between their receipt and disbursement of federal program funds.

Of the 40 expenditure transactions we reviewed for the Migrant Education—Basic State Grant Program, 37 were payments to 18 of Education's 22 regional offices. We compared Education's first advance payment to these regional offices against their mid-year expenditure reports, and found that 6 had high ending cash balances ranging from $80,300 to $964,900. We considered any positive balance high because Education disbursed the first advance payment, approximately 40 percent of the sub-awards, by November 2000. This was at least three months before the end of the six-month period for which the regional offices reported expenditures. Further, for 1 of these 18 regional offices, Education did not receive a six-month expenditure report; therefore, it could not determine this region's cash balance.

Additionally, for the Special Education—Grants for Infants and Families with Disabilities program, 9 of the 40 subrecipients we reviewed received higher cash advances than needed that ranged from $4,500 to $36,600. Education paid these 9 subrecipients approximately 50 percent of their sub-awards in April 2001, but did not assess their cash needs because Education did not receive reports of subrecipient program expenditures as of March 31, 2001, until after it made this first payment. Furthermore, in May 2001, Education paid 7 of these 9 subrecipients an additional 25 percent of their sub-awards. However, before making this payment, Education had received the expenditure reports for 5 of the 7 that showed they did not yet require additional funds. For the remaining 2 subrecipients, Education did not receive the expenditure reports in time to assess their cash needs before it made the second payment.

Finally, for the Class Size Reduction program, Education's first payment to subrecipients was disbursed in February 2001, and was for 80 percent of their sub-awards. However, Education did not assess the subrecipients' cash needs because it did not require them to submit expenditure reports until June 1, 2001. We compared Education's payments to 40 program subrecipients against their expenditure reports and found that 8 out of 26 had ending cash balances that exceeded 10 percent of

their first payment for the current year plus any unspent cash balances carried forward from the previous year. These cash balances ranged from $700 to $371,900. For the other 14 subrecipients, Education could not determine their cash balances because 13 had not submitted expenditure reports by June 1, 2001, and 1 submitted an incorrect report.

When Education does not assess its subrecipients' immediate cash needs before making federal program advances, it cannot assure that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Additionally, Education did not require subrecipients to report and remit interest in excess of $100 earned on these federal program advances. As a result, these subrecipients may use the interest earned on federal program advances for activities that may not be allowable.

RECOMMENDATIONS

To minimize the time elapsing between the receipt and use of federal program funds, Education should implement procedures to assess each subrecipient's cash needs and adjust its advance payments to more closely reflect each of its subrecipients' immediate cash needs. Additionally, Education should ensure its subrecipients report their program expenditures in time to allow Education to assess their cash needs before making additional advance payments. Education should also require subrecipients to report and pay it interest earnings greater than $100 on these advances so it can repay these interest earnings to the federal awarding agency. Finally, if Education cannot demonstrate its ability to ensure subrecipients minimize the time elapsing between the receipt and disbursement of federal program advances, it should implement procedures to pay its subrecipients on a reimbursement basis rather than paying them in advance.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The Local Education Agencies (LEAs) receive an initial advance based on their grant award. Migrant Education, Special Education and Class Size Reduction will require each LEA to submit an interim expenditure report before the next apportionment is made. Based on information reported in the expenditure report, Migrant Education, Special Education and Class Size Reduction may make adjustments to the LEAs' next apportionment.

Migrant Education, Special Education and Class Size Reduction have added an additional reporting field to the expenditure report requesting the amount of interest earned over $100. Education will explore options in determining the best approach to take in recovering any interest earned over $100.

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A000005; 2000

Federal Catalog Number:	84.181
Federal Program Title:	Special Education—Grants for Infants and Families with Disabilities
Federal Award Number and Calendar Year Awarded:	H181A000037; 2000

Federal Catalog Number:	84.340
Federal Program Title:	Class Size Reduction
Federal Award Number and Calendar Year Awarded:	S340A000005A; 2000

Reference Number:	2001-3-5
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Numbers and Calendar Years Awarded:	H126A000005; 1999 H126A010005; 2000
Category of Finding:	Cash Management
State Administering Department:	Department of Rehabilitation

CRITERIA

We determined that the following requirements relate to compliance with the Cash Management Improvement Act Agreement (CMIA agreement) between the U.S. Department of the Treasury and the State:

The CMIA agreement, sections 9.4.1 and 9.6.1, establishes requirements for calculating the State's interest liability. Sections 9.4.3 and 9.6.2 provide the methods for calculating this interest liability.

CONDITION

The Department of Finance (Finance) requires state departments to report information related to the receipt and disbursement of federal funds so that it can calculate the State's interest liability under the CMIA agreement. However, our review of the worksheets used in the calculation of the interest liability revealed an error in a formula in the first-quarter worksheet sent to Finance by the Department of Rehabilitation (Rehabilitation). Specifically, the formula that Rehabilitation used to calculate the subtotals for the expenditures did not include two expenditures totaling $2.5 million. Because of these errors, Finance understated the net federal liability by more than $110,000 in its CMIA annual report to the federal government. Consequently, the State will not recoup this loss of more than $110,000 for fiscal year 2000-01 from the federal government until March 2003.

RECOMMENDATION

Rehabilitation should ensure that the quarterly worksheets submitted to Finance are mathematically accurate and complete.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Rehabilitation agrees with the finding and states that it will review its worksheets more closely to prevent this type of error from happening in the future.

Reference Number:	2001-3-7
Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Number and Calendar Year Awarded:	S186B000005; 2000

Category of Finding: Cash Management

State Administering Department: Department of Alcohol and Drug Programs

CRITERIA

Our review of the Safe and Drug-Free Schools and Communities—State Grants (Safe and Drug-Free Schools) program identified the following compliance requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, this section requires subrecipients to promptly pay the federal agency any interest greater than $100 that they earned on the advances. Additionally, if subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

CONDITION

The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure that subrecipients of the Safe and Drug-Free Schools program minimize the time elapsing between receipt and use of program funds.

DADP awards subgrants to counties to carry out the program's activities. In accordance with state law, DADP makes monthly subgrant payments to counties regardless of their actual expenditures. DADP also does not require the counties to submit invoices to support the monthly payments. Although DADP is instituting procedures to track county expenditures quarterly to better assess each county's cash needs, it had not yet fully implemented these procedures during fiscal year 2000-01. DADP's target date for full implementation is July 1, 2002. As a result, DADP cannot be sure that counties minimized the time between the counties' receipt and use of federal funds throughout the year.

Additionally, although DADP's agreements with the counties require them to remit interest in excess of $100 earned on federal program advances, DADP did not require counties to report that interest. As a result, DADP does not know if any counties earned interest greater than $100 on federal program advances and whether counties should be remitting interest earnings to it.

RECOMMENDATIONS

DADP should continue implementing its new procedures to ensure that the counties participating in the program minimize the time elapsing between their receipt and use

of federal program funds. DADP should also require the counties to report and pay DADP any interest earnings greater than $100 on these advances so it can repay these interest earnings to the federal awarding agency.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

DADP will continue to implement procedures to ensure that counties minimize the time elapsing between receipt and use of federal program funds.

Reference Number:	2001-3-8
Category of Finding:	Cash Management
State Administering Department:	California Community Colleges, Chancellor's Office

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following requirements relating to cash management:

The Code of Federal Regulations, Title 34, Section 80.21, allows subrecipients to receive advance payments provided they demonstrate the ability to minimize the time elapsing between the receipt and disbursement of federal funds. Otherwise, reimbursement is the preferred method of payment. Further, except in certain circumstances, this section requires subrecipients to promptly pay to the federal agency any interest greater than $100 per year that they earned on the advances. Additionally, if subrecipients receive advance payments, Section 80.20(b)(7) requires them to follow procedures for minimizing the time between the receipt and disbursement of federal funds.

CONDITION

The California Community Colleges, Chancellor's Office (Chancellor's Office) does not have adequate procedures to ensure that subrecipients of the Vocational Education—Basic Grants to States program (Vocational Education) and the Tech-Prep Education program (Tech-Prep) minimize the time elapsing between their receipt and use of federal program funds. Under its payment procedures, the Chancellor's Office approves program advances for each subrecipient and disburses these advances monthly based on predetermined percentages. However, because the

Chancellor's Office approves advances that exceed some subrecipients' immediate cash needs, some subrecipients carry excessive cash balances during the fiscal year. Further, the Chancellor's Office does not require subrecipients to report and pay it the excess interest earned on these federal program advances.

The Chancellor's Office approves subrecipient applications, calculates advances equal to 84 percent of the subrecipients' approved allocations, and pays these advances in monthly installments. However, because these advances are not based on each subrecipient's cash needs, some subrecipients receive monthly advance payments that may exceed their immediate cash needs. To determine if a subrecipient's spending appears reasonable, the Chancellor's Office uses the subrecipients' quarterly year-to-date expenditures and progress reports to compare the reported expenditures to the amounts it advanced to each subrecipient. If it determines that a subrecipient's spending appears reasonable, the Chancellor's Office authorizes further advance payments; otherwise, it may contact the subrecipient to obtain an explanation of expenses, reduce the subrecipient's monthly advance payments, or deny additional payments. However, the Chancellor's Office does not specify or provide guidance on what level of spending it considers reasonable. Furthermore, when the Chancellor's Office determines that a reduction in the monthly advance payment amount is warranted, it begins making these adjustments in the third quarter of the fiscal year.

Our review of the Chancellor's Office payments to subrecipients of the Vocational Education program and the subrecipients' reported expenditures found that 17 of the 25 subrecipients we reviewed maintained high cash balances ranging from $14,138 to $566,319 for one or more quarters. We considered balances high when they exceeded 10 percent of the amounts advanced by the Chancellor's Office. Similarly, for the Tech-Prep program, 9 of the 13 subrecipients we reviewed maintained high cash balances ranging from $7,326 to $112,942 for one or more quarters. Because the Tech-Prep program subgrants are small, we considered balances high when they exceeded $7,000 and 10 percent of the amounts advanced for this program.

The Chancellor's Office stated that because some subrecipients experience delays in posting expenditures to their accounting records, these subrecipients underreport the program funds spent during the interim quarters. The Chancellor's Office asserts that most subrecipients spend all the program funds they receive by the last quarter. However, the Chancellor's Office is responsible for ensuring that subrecipients minimize the time between the subrecipients' receipt and use of federal funds throughout the year. When the Chancellor's Office does not adequately assess its subrecipients' immediate cash needs before approving monthly advances, it cannot assure that subrecipients minimize the time elapsing between the receipt and use of federal funds.

Additionally, the Chancellor's Office did not require subrecipients to report and pay it interest exceeding $100 earned on these federal program advances. As a result, these subrecipients may use the interest earned on federal program advances for activities that may not be allowable.

RECOMMENDATIONS

To minimize the time elapsing between the receipt and use of federal program funds, the Chancellor's Office should use relevant spending data to assess each of its subrecipients' immediate cash needs and approve initial advances that reflect these needs. Additionally, the Chancellor's Office should ensure its subrecipients promptly post their expenditure transactions so that their expenditure reports reflect the most current actual program expenditures. The Chancellor's Office should also require subrecipients to report and pay it interest earnings greater than $100 on these advances so it can repay these interest earnings to the federal awarding agency.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The 2001-02 Vocational and Technical Education (VTEA) Title IC funds were certified for apportionment based upon each district's expenditures through the third quarter of 2000-01. Districts were certified at either 66% or 83% of their tentative allocations (districts receive 84% of the amount certified). The 2001-02 VTEA Title IB funds and Title II funds were certified at 100% of their grant amount (districts receive 84% of the amount certified). The rationale for this is that the Title IB grants were funded from March 2001 through June 2002, and the potential of a low rate of expenditures in the first quarter was minimal. The Title II grants, in comparison, are mainly small, and to reduce the certification might impair a district's ability to fund the activities of the grant.

The Chancellor's Office compared each district's 2001-02 first quarter expenditures with the amount of their first quarter apportionment for all VTEA funds. As a result of the analysis, districts were certified at the First Principal Apportionment at 25%, 50%, 75% or 100%. Districts were notified of the changes in the amount certified for apportionment. These notifications can be found at the Vocational Education Services Team (VEST) web site at:

http://www.cccco.edu/cccco/voced/Resources/2002Memos/2002memos.htm

VEST Memo 02-06 and 02-06A is the information for the Title IC funds. VEST Memo 02-07 and 02-07A is the information for the Title IB funds. The notification for Title II funds is pending.

These steps should serve as an incentive for districts to report expenditures in an expedient manner.

Language will be added to the Grant Agreement Articles to the effect that "districts must report and pay interest earnings greater than $100 to the federal awarding agency on any funds that are in excess of the amount received through apportionment." In addition, the Chancellor's Office will issue a memo reminding districts of their responsibility to send interest earnings in excess of $100 to the federal government and we will have the districts' contracted auditors monitor compliance.

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A000005A; 2000

Federal Catalog Number:	84.243
Federal Program Title:	Tech-Prep Education
Federal Award Number and Calendar Year Awarded:	V243A000005; 2000

Reference Number:	2001-5-2
Federal Catalog Number:	84.126
Federal Program Title:	Rehabilitation Services—Vocational Rehabilitation Grants to States
Federal Award Numbers and Calendar Years Awarded:	H126A000005; 1999 H126A010005; 2000
Category of Finding:	Eligibility
State Administering Department:	Department of Rehabilitation

CRITERIA

Our review of the Rehabilitation Services—Vocational Rehabilitation Grants to States program (Vocational Rehabilitation) determined that the following are among the compliance requirements for eligibility:

The Code of Federal Regulations, Title 34, Section 361.42, requires the State to conduct an assessment for determining an applicant's eligibility and priority for program services. This section further requires the State to base the applicant's eligibility only on a determination that:

- The individual has a physical or mental impairment.
- The impairment substantially impedes employment.

- A presumption that the individual can benefit from program services.
- The individual requires program services to prepare for, secure, or retain employment.

Additionally, Section 361.41 requires the State to determine an individual's eligibility for program services within 60 days of receiving their application, with certain exceptions.

CONDITION

The Department of Rehabilitation (Rehabilitation) does not always determine applicant eligibility for the Vocational Rehabilitation program within the required time period. Of the 32,438 applications received by Rehabilitation from July 1, 2000, through April 30, 2001, Rehabilitation did not determine in 6,260 cases (19 percent) an applicant's eligibility within 60 days or within the time period Rehabilitation and the applicant agreed on when an eligibility-determination extension was used. Rehabilitation was fewer than 10 days late in 38.9 percent of these cases, between 11 and 30 days late in another 30.6 percent of the cases, and between 31 and 60 days late in an additional 17 percent of the cases. Rehabilitation was 61 days or more late in 13.4 percent of the cases. Further, Rehabilitation had not determined eligible or had not closed an additional 1,802 cases as of August 1, 2001. These tardy determinations occurred because although Rehabilitation has the ability to provide district office managers with information on applications that are approaching the deadline for eligibility determinations, it does not do so. When Rehabilitation does not determine an applicant's eligibility within the required time period, it reduces the assurance that clients receive the required rehabilitative services promptly.

RECOMMENDATIONS

To make sure applicants receive program services promptly, Rehabilitation should determine eligibility within the required time period. One approach would be for Rehabilitation to develop "best practices" for its districts to use to approve applications within the required time period and share them with all districts. Also, to help ensure that it determines eligibility timely, Rehabilitation should develop reports, such as aging reports, that show which applications are approaching the eligibility determination deadline. Rehabilitation should provide these reports to supervisors and managers, as necessary, to pinpoint problem areas and help them improve the services Rehabilitation provides to applicants.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Rehabilitation generally agrees with the finding and will consider these recommendations as part of its continuing efforts to streamline and improve the vocational rehabilitation process.

Rehabilitation held a statewide district administrators' meeting in October 2001 and discussed this finding. It is committed to identifying best practices in the determination of eligibility for consumers. Through its preliminary analysis of the causes for the finding, it identified districts that are managing the eligibility-determination process most effectively. Those districts' management practices will be shared with all districts. With the district administrators' input, Rehabilitation is working toward the improvement of the timeliness and accuracy of the management-information reports that are currently available to the districts. Using these reports, Rehabilitation will be able to ensure the consistent use of the management-information reports by the districts to identify consumers who are due for eligibility determination or extension of the eligibility-determination period. For districts that continue to have significant noncompliance issues, Rehabilitation will develop strategies and timelines to resolve the issues.

In addition, based upon recommendations received from its Continuous Improvement Workgroup, Rehabilitation will provide counselors with training that focuses on eligibility determination, specifically as it relates to an applicant's ability to benefit from an employment outcome and the requirements under federal regulation.

Reference Number:	2001-9-3
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A000005A; 2000
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Education

CRITERIA

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirements related to suspension and debarment:

The Code of Federal Regulations, Title 34, Section 85.225, prohibits the State from contracting with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. In addition, Section 85.510 mandates the State to require certifications from participating organizations affirming that they are not suspended, debarred, ineligible, or voluntarily excluded from transactions by any

federal agency. Further, Section 85.110 makes procurement contracts for goods or services expected to equal or exceed $100,000 subject to the suspension and debarment certification requirements.

CONDITION

The Department of Education (Education) did not obtain the required suspension and debarment certifications from six of eight contractors we reviewed. Education awarded these participants of the Vocational Education program procurement contracts of $100,000 or more. According to Education, it did not obtain these certifications because its employees were unaware of the requirements as they relate to vendors. When Education does not obtain the required certifications, it risks unknowingly allowing suspended or debarred parties to participate in the Vocational Education program. For the transactions we reviewed, we used an alternative test to determine that these participants were not on the federal suspended or debarred list.

RECOMMENDATION

Education should ensure that Vocational Education participants receiving procurement contracts of $100,000 or more submit the required suspension and debarment certification before Education approves their participation in the Vocational Education program.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The required form [Certifications Regarding Lobbying; Debarment, Suspension and other Responsibility Matters; and Drug-Free Workplace Requirements] was mailed to each of the affected contractors for the required signature and return. Education will file the returned forms with the appropriate procurement agreements.

Reference Number:	2001-9-4
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following requirements related to suspension and debarment:

The Code of Federal Regulations, Title 34, Section 85.225, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Section 85.510 mandates the State to require a certification from organizations submitting proposals certifying that neither the organization nor its principals are presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in federal assistance programs by a federal agency.

CONDITION

The Department of Education (Education) needs to improve its procedures for obtaining the required suspension and debarment certifications. Specifically, Education did not require local education agencies (LEAs) applying to participate in the Title I Grants to Local Educational Agencies program (Title I, Part A) and the Class Size Reduction program to submit the required suspension and debarment certifications. Instead, Education required LEAs to assure that they had complied with the certification requirement. According to Education, the certifications are maintained at the LEA offices and Education reviews these certifications during its site reviews. However, Education only conducts site reviews of LEAs on a four-year cycle; therefore, it cannot annually review each LEA's certification. Thus, although it requires LEAs to apply for program funding annually, Education cannot demonstrate that LEAs made the required certification before it approved their participation in the program.

When Education does not require participants in the Title I, Part A and Class Size Reduction programs to submit the required certification when they apply for program funding, it risks unknowingly allowing suspended or debarred parties to participate in the federal programs. For the transactions we reviewed, we used an alternative test to determine that these program participants were not on the federal suspended or debarred list.

RECOMMENDATION

Education should establish procedures that require participants in the Title I, Part A and Class Size Reduction programs to submit the required suspension and debarment certification before it approves their participation in the programs.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The Consolidated Application, Part 1 for school year 2002-2003 will be revised and sent to LEAs in April 2002. The revised Consolidated Application will require the LEAs that apply for funding through the Consolidated Application to submit the following statement of assurance:

> "The LEA certifies that neither it, nor its principals is presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation by any Federal department or agency."

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Calendar Year Awarded:	S010A000005; 2000

Federal Catalog Number:	84.340
Federal Program Title:	Class Size Reduction
Federal Award Number and Calendar Year Awarded:	S340A000005A; 2000

Reference Number:	2001-12-2
Category of Finding:	Reporting
State Administering Department:	Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) and the Title I Grants to Local Educational Agencies program (Title I, Part A) identified the following requirements related to reporting of school fiscal and student attendance data:

The United States Code, Title 20, sections 6333 and 6393, provide for the use of state average per-pupil expenditures (per-pupil expenditures) in determining the program funds the federal government allocates to states. The National Center for Education Statistics (center) issues instructions on how states are to report data in the National Public Education Financial Survey report (fiscal report) that the center uses to calculate per-pupil expenditures. The center divides the reported state net current expenditures by the reported average daily attendance (ADA) to calculate per-pupil expenditures. The center's instructions specify two methods for states to use when reporting ADA in the fiscal report. Method A requires states to report ADA as defined by state laws or regulations. Method B, which must be used if states do not have laws or regulations defining ADA, requests states to use the center's definition of ADA, which includes summer school ADA.

CONDITION

The Department of Education (Education) did not report the correct ADA in its 1999 fiscal report. Specifically, Education used method A when it reported total ADA in the 1999 fiscal report it submitted to the center. Although it excluded the summer school ADA from the total ADA it reported, Education could not demonstrate which state laws or regulations allow it to exclude summer school ADA from the calculation of total ADA. As a result of Education's omission, it overstated California's per-pupil expenditures by approximately $122.

According to Education, it excluded the summer school ADA from total ADA because California is moving toward a seamless instructional calendar, and including the summer school ADA would double-count students who are served throughout the year in a variety of circumstances. However, the center's position is that excluding summer school ADA may falsely inflate the State's reported per-pupil expenditures. The center noted that per-pupil expenditures have a direct impact on the federal allocations to states, and that reporting inaccuracies may result in the federal government seeking to recover overpayments. The center estimates that the federal government overpaid California more than $400,000 because of Education's underreporting of ADA in its 1999 fiscal report.

When Education underreports ADA in its fiscal reports, it risks receiving and spending federal program funds that the federal government may later ask California to repay.

RECOMMENDATIONS

Education should include summer school ADA in the total ADA that it reports and that the federal government uses to calculate California's per-pupil expenditures. In addition, Education should work with the federal awarding agency to resolve any fiscal effects from its inflated fiscal year 1998-99 per-pupil expenditures.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Education included summer school average daily attendance (ADA) in the subsequent year's 1999-2000 fiscal report, and will work with the federal awarding agency to resolve any fiscal effects of excluding summer school ADA from the 1998-1999 fiscal report. In May 2000, Education wrote to the Acting Commissioner of Education Statistics stating reasons why summer school ADA should be excluded.

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Calendar Year Awarded:	S010A000005; 2000

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A000005; 2000

Reference Number:	2001-12-3
Federal Catalog Number:	84.048
Federal Program Title:	Vocational Education—Basic Grants to States
Federal Award Number and Calendar Year Awarded:	V048A000005A; 2000
Category of Finding:	Reporting
State Administering Department:	Department of Education

CRITERIA

Our review of the Vocational Education—Basic Grants to States program (Vocational Education) identified the following requirement related to performance reports:

The United States Code, Title 20, Section 2323(c), requires the State to prepare and submit an annual report containing data as to whether it met its adjusted performance levels for each of four core indicators of performance and any state indicators of performance.

CONDITION

The Department of Education (Education) did not report accurate, complete, and supported data in its Vocational Education performance accountability report. To prepare its accountability report, Education obtains performance data from local educational agencies (LEAs) and enters this data into a database it has established to compile the statewide information it reports in its accountability report. However, for 19 of the 35 LEAs we reviewed, Education's entry of LEA data into its database was either inaccurate or incomplete, resulting in Education reporting unreliable information. Education also misreported the total for one core indicator that assesses the State's performance. According to Education, this was its first attempt to prepare this new report, and because of initial flaws in both its data-gathering mechanisms and data-entry procedures, it made errors. When Education does not compile and report accurate and complete data, the U.S. Department of Education cannot accurately assess the State's performance in the Vocational Education program.

RECOMMENDATIONS

Education should implement procedures to ensure that all LEAs submit data, that the data it enters into its database is accurate and complete, and that the information it reports in its Vocational Education performance report is supported.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The forms developed for LEA use in collecting and reporting the required enrollment, completion, and placement data have been rewritten with improved instructions and clearer definitions. Education is assisting LEAs with the implementation of electronic systems for collecting and reporting the required Consolidated Annual Performance, Accountability and Financial Status Report information. Education is also developing a system for electronically receiving and aggregating the enrollment, completion and placement data submitted by the LEAs. This system will be operational by October 2002.

Reference Number: 2001-14-3

Category of Finding: Special Tests and Provisions

State Administering Department: Department of Education

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of the Migrant Education—Basic State Grant Program (Migrant Education) and the Title I Grants to Local Educational Agencies program (Title I, Part A) determined that the following compliance requirements relate to the comparability of school services:

The United States Code, Title 20, sections 6322(c) and 6394(c), requires local educational agencies (LEAs) that receive Migrant Education and Title I, Part A funds to use state and local funds to provide school services that are at least comparable to services provided by schools not receiving these federal funds, unless otherwise excluded. Furthermore, these sections state that an LEA will have met the requirement of comparability if the LEA has filed with the State education agency a written assurance that the LEA has established and implemented an LEA-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies.

CONDITION

The Department of Education (Education) did not require LEAs receiving Migrant Education and Title I, Part A funds to file with Education a specific written assurance stating that the LEAs have established and implemented an LEA-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies. Instead, Education required each LEA to agree to follow standard legal assurances for the respective programs. However, these assurances fall short of the written assurance specified by federal law.

The Migrant Education legal assurance specified for LEAs the comparability requirements, but did not require LEAs to submit a written assurance. The Title I, Part A legal assurance stated, “the LEA has developed and implemented procedures for compliance with the comparability requirements and the compliance documents are updated biannually.” However, this assurance does not state that the LEA has actually established and implemented the specific policies and procedures that federal law requires to ensure comparable school services. Moreover, Education instructed

LEAs to keep these legal assurances on file and not submit them to Education. In addition, although Education reviews local policies during its LEA site visits, it only reviews each LEA on a four-year cycle, and the review instrument it uses does not specify reviewing the policies and procedures to ensure comparable school services. Therefore, Education cannot be sure that LEAs have established and implemented the policies and procedures federal law requires to ensure comparable school services.

When Education does not require LEAs to assure to it in writing that they have implemented specific policies and procedures for using state and local funds to provide school services that are at least comparable to the services provided by schools not receiving Migrant Education and Title I, Part A funds, it cannot be sure that LEAs are using these federal program funds to provide educationally disadvantaged students the additional assistance they need to achieve academic success.

We reported similar findings in our audits of fiscal years 1998-99 and 1999-2000 for these programs. At the time, Education stated it would continue to work with the U.S. Department of Education (USDE) to resolve a similar finding for the Title I, Part A program that the USDE identified in a 1998 Integrated Review report. Further, Education stated that once the comparability issue was satisfactorily resolved for Title I, Part A, it would also be resolved for all Title I programs, including Migrant Education. Although Education has communicated and emphasized the importance of the comparability requirement to LEAs, it has not yet resolved this issue with the USDE.

RECOMMENDATIONS

Education should require LEAs to file with Education written assurances stating that the LEAs have established and implemented the specific policies and procedures federal law requires to ensure they use state and local funds to provide comparable services to all their schools. Additionally, Education should continue to work with the USDE about how Education should revise its monitoring process to ensure that LEAs comply with the comparability requirement.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

The Consolidated Application, Part 1 for school year 2002-2003 will be revised, and sent to the LEAs in April 2002. The revised Consolidated Application will require the LEAs that apply for funding through the Consolidated Application to submit the following statement of assurance:

> "The LEA has established and implemented a district-wide salary schedule; a policy to ensure equivalence among schools in teachers, administrators, and other staff; and a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies."

In addition to the assurance above, Education will submit a letter to the districts reminding them of their obligations under Title I, Part A Section 1120(c)(2, 3, 4, 5).

Education will continue to work with the U.S. Department of Education to determine the expectation for monitoring this effort.

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.010
Federal Program Title:	Title I Grants to Local Educational Agencies
Federal Award Number and Calendar Year Awarded:	S010A000005; 2000

Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education—Basic State Grant Program
Federal Award Number and Calendar Year Awarded:	S011A000005; 2000

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

Reference Number:	2001-8-2
Category of Finding:	Period of Availability
State Administering Department:	Department of Alcohol and Drug Programs

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following compliance requirements relating to period of availability:

The Code of Federal Regulations, Title 34, Section 76.709(a), mandates that if the State does not obligate all of its Safe and Drug-Free Schools and Communities—State Grants (Safe and Drug-Free Schools) program funds by the end of the 15-month funding period for which they were appropriated, the State may obligate the remaining funds for one additional year. In addition, Section 80.23(b) requires the State to liquidate all obligations incurred under an award no later than 90 days after the end of the funding period, which means the State has two years and six months to liquidate its obligations.

Additionally, the United States Code, Title 42, Section 300x-62, requires the State to obligate any Substance Abuse Prevention and Treatment Block Grant amounts by the end of the fiscal year in which the amounts are awarded; and if obligated, spend these amounts by the end of the next fiscal year.

CONDITION

The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure that federal grant awards are obligated and spent within their applicable periods of availability. DADP charged at least $235,357 against Safe and Drug-Free Schools awards that were not available to DADP at the time. Also, DADP charged at least $577,441 against Substance Abuse Prevention and Treatment Block Grant awards outside the periods of availability.

Specifically, during fiscal year 2000-01, DADP charged $89,000 to a Safe and Drug-Free Schools grant award for services that likely occurred before the award was available for obligation and expenditure. Additionally, DADP inappropriately charged at least $146,357 to a Safe and Drug-Free Schools award for services billed or provided after the grant award had expired. Similarly, for the Substance Abuse Prevention and Treatment Block Grant program, DADP charged at least $116,716 to a

grant award for services that were provided after the award's period of availability had expired. Furthermore, because DADP did not correctly update the coding in its automated accounting system, it allocated at least $460,725 of costs to incorrect Substance Abuse Prevention and Treatment Block Grant awards. When DADP does not ensure it charges expenditures only to appropriate and available grant awards, it risks making expenditures for which the federal government may decide not to reimburse it.

Finally, DADP has not fully implemented procedures to reconcile its Substance Abuse Prevention and Treatment Block Grant award expenditures with the grant award fund transfers reflected on the federal awarding agency's Payment Management System. When DADP does not reconcile its expenditures and federal fund transfers for each grant award, it cannot adequately track and be sure it uses the grant award funds before their availability period expires.

RECOMMENDATIONS

DADP should strengthen its procedures to ensure it obligates and expends funds only during each grant award's period of availability. In addition, DADP should continue to implement procedures to reconcile grant award expenditures with the corresponding grant award fund transfers it receives from the federal awarding agency. Finally, DADP should determine appropriate adjustments to its accounting records and refund to the federal awarding agencies any Safe and Drug-Free Schools program funds and Substance Abuse Prevention and Treatment Block Grant program funds that it inappropriately spent outside the applicable periods of availability.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

DADP is continuing to improve its procedures for ensuring that obligations and expenditures are recorded only during each grant award's period of availability. Training is being provided to both fiscal and program staff to enhance their understanding of the period of availability for each grant award.

A format for the reconciliation of expenditures and grant transfers has been developed and a regular, monthly reconciliation has been fully implemented for the Safe and Drug-Free Schools program grants. The significantly higher volume of activity in the Substance Abuse Prevention and Treatment Block Grant program has required a longer period of research and will be implemented by July 1, 2002.

DADP is reviewing its accounting records to determine if items identified as outside the period of availability could appropriately be charged to a current award. Once the appropriate adjustments are made, any remaining funds for which the expenditures fall outside the period of availability will be returned to the granting agency.

U.S. DEPARTMENT OF EDUCATION

Federal Catalog Number:	84.186
Federal Program Title:	Safe and Drug-Free Schools and Communities—State Grants
Federal Award Numbers and Calendar Years Awarded:	S186B70005; 1997 S186B990005; 1999

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.959
Federal Program Title:	Substance Abuse Prevention and Treatment Block Grant
Federal Award Numbers and Calendar Years Awarded:	98B1CASAPT; 1997 99B1CASAPT; 1998 00B1CASAPT; 1999

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Reference Number:	2001-3-1
Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Calendar Years Awarded:	5X07HA00041-10; 2000 2X07HA00041-11; 2001
Category of Finding:	Cash Management
State Administering Department:	Department of Health Services

CRITERIA

Our review of the HIV Care Formula Grants program identified the following compliance requirements related to cash management:

The Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for programs not covered in the Cash Management Improvement Act agreement between the U.S. Department of the Treasury and the State. Section 205.20 of this subpart requires the State to limit the cash advances from the U.S. Department of the Treasury to the minimum amounts needed. The subpart also requires the State to time the advances, as close as it can, with its actual and immediate cash needs to carry out the program.

CONDITION

The Department of Health Services (Health Services) did not always minimize the amount of time elapsing between the transfer of federal funds to the State and the funds' disbursement for program costs. Specifically, the time between the receipt of federal funds and the issuance of warrants in 12 of 40 transactions we reviewed ranged from 5 to 23 days. For 7 of those transactions, the elapsed time was 10 days or more. When Health Services does not minimize the amount of time between the receipt and disbursement of federal funds, the State improperly earns interest while federal funds are held in state accounts. For the 12 transactions, we estimate that the State earned about $2,200 in interest.

RECOMMENDATION

To minimize the time elapsing between the receipt and disbursement of federal funds, Health Services should request federal funds closer to the date that warrants for program costs are released.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services agrees with the finding. It also notes that the Cash Management Improvement Act (CMIA) agreement between the U.S. Treasury and the State for fiscal year 2001-02 identifies the HIV Care Formula Grants program as being subject to the tracking and reporting requirements of the CMIA. Health Services states that it will comply with federal requirements.

Reference Number:	2001-3-4
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance
Federal Award Number and Calendar Year Awarded:	G-00B1CALIEA; 1999
Category of Finding:	Cash Management
State Administering Department:	Department of Community Services and Development

CRITERIA

Our review of the Low-Income Home Energy Assistance program determined that the following are among the compliance requirements for cash management:

The Code of Federal Regulations, Title 31, Part 205, Subpart B, provides the cash management requirements for programs not covered in the Cash Management Improvement Act agreement between the U.S. Department of the Treasury and the State. Section 205.20 of this subpart requires the State to limit the cash advances from the U.S. Department of the Treasury to the minimum amounts needed. The subpart also requires the State to time the advances, as close as it can, with its actual and immediate cash needs to carry out the program.

CONDITION

The Department of Community Services and Development (Community Services) did not always minimize the amount of time elapsing between the transfer of federal funds to the State and the funds' disbursement for Low-Income Home Energy Assistance program costs. Specifically, the time between receipt of federal funds and the issuance of warrants in 34 of the 40 transactions we reviewed ranged from 4 to 12 days. Four of these transactions took 10 days or more. When Community Services does not minimize the amount of time between the receipt and disbursement of federal funds, the State improperly earns interest on federal funds held in state accounts. For the 34 transactions, we estimate that the State earned approximately $7,700 in interest.

RECOMMENDATION

To minimize the time elapsing between the receipt and disbursement of federal funds, Community Services should request federal funds closer to the date that warrants for program costs are released.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Community Services recognized this situation and during June 2001 entered into an interagency agreement with the State Controller's Office (SCO) allowing it to pay an additional $25 to expedite the payment of each claim schedule sent to the SCO. This will ensure that disbursements are made within seventy-two hours after receipt of federal funds. The agreement will allow Community Services to further its efforts in minimizing the time elapsing between the receipt and disbursement of federal funds.

Reference Number:	2001-3-6
Federal Catalog Number:	93.658
Federal Program Title:	Foster Care—Title IV-E
Federal Award Number and Calendar Year Awarded:	0001CA1401; 1999
Category of Finding:	Cash Management, Reporting
State Administering Department:	Department of Social Services

CRITERIA

Our review of the Foster Care—Title IV-E (Foster Care) program identified the following requirements for cash management and reporting:

The Code of Federal Regulations, Title 45, Section 74.21, requires the State to maintain accurate accounting records and to properly track and report financial activities related to federal grants. This section also requires the State to minimize the time between the transfer of funds from the U.S. Treasury and the disbursement of these funds for program purposes. Additionally, this section requires the State's payment methods to be consistent with the Cash Management Improvement Act Treasury-State Agreement (CMIA Treasury-State Agreement) when applicable. For programs covered under a CMIA Treasury-State Agreement, the State owes the federal government interest from the time the State deposits federal funds in a state account until the State pays the funds for program purposes.

CONDITION

The Department of Social Services (Social Services) overstated its disbursements by more than $1 million and understated its cash on hand by the same amount for its Foster Care program on the federal cash transaction report to the federal government. Most of this amount—more than $983,000—represents excess cash Social Services drew down from the U.S. Treasury on July 28, 2000. The remaining amount, more than $27,000, represents unused funds returned by a county on February 9, 2001. Social Services erroneously reported this cash on hand as disbursements. When Social Services does this, it overstates the amount of federal funds spent on program purposes and understates the amount of cash it has on hand to meet program needs.

Additionally, although the program is covered by the CMIA Treasury-State Agreement, Social Services did not report to the Department of Finance (Finance), the state agency responsible for calculating the State's interest liability, the correct information reflecting how long it was maintaining this cash balance. As a result, Finance calculates that the State's interest liability for the Foster Care program was understated by more than $55,000.

RECOMMENDATIONS

Social Services should ensure that it accurately reports disbursements and cash on hand in its federal cash transaction reports. Additionally, it should monitor its cash balances for its federal programs and ensure that it requests only the federal cash necessary to meet its immediate program needs.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Social Services concurs. Social Services realizes the importance of monitoring its cash balances given that it disburses approximately $7 billion in federal funds annually. Social Services is now directing more focus to monitoring cash-on-hand at the State Controller's Office and on following up to ensure staff uses cash for program purposes within a reasonable period of time. Social Services will also review its reporting procedures for the cash transaction report and for its CMIA agreement to ensure they are consistent with federal reporting requirements.

Reference Number:	2001-7-1
Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Numbers and Calendar Years Awarded:	6B04MC00336-03; 1999 6B04MC00336-04; 2000
Category of Finding:	Earmarking
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Maternal and Child Health Services Block Grant to the States program (program) determined that the following compliance requirements apply to earmarking:

The United States Code, Title 42, Section 705(a)(3), requires states generally to use at least 30 percent of program payments for preventative and primary health care for children, and at least 30 percent for services for children with special health care needs. In addition, Section 704(d) prohibits states from using more than 10 percent of the annual grant amount to administer the program's funds.

CONDITION

The Department of Health Services (Health Services) does not have adequate procedures to ensure that it meets the program's earmarking requirements. As a result, it cannot be sure that children received sufficient levels of service and that it spent federal funds in compliance with federal requirements. Rather than reflecting in its accounting system the actual amounts spent for each of the three earmarked

components, Health Services uses predetermined percentages to allocate subrecipient and contractor payments to these areas. Health Services believes that requiring contractors to report actual amounts spent on each type of individual served and by service provided would create undue administrative hardships.

RECOMMENDATION

Health Services should obtain formal approval from the federal government of the procedures it uses for calculating how it meets the earmarking requirements.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services agrees that it uses predetermined percentages to estimate the amounts spent for each of the required program components. It also believes that using estimates is the most viable approach to spreading costs to these components. Health Services states that the assigned percentages are based on the target population. It also based them on the program activities that are established by legislative authorization and specified in the scope of work for each contractor.

Health Services states that it has informally contacted the federal Maternal and Child Health Bureau (federal bureau) regarding its interpretation of this requirement and how other states implement the 30-30-10 allocation. According to Health Services, the federal bureau said that it does not routinely review the methodology states use to meet the earmarking requirements. Health Services asserts that if based upon this finding the federal bureau determines that California is not in compliance with this requirement, Health Services will work directly with the federal bureau to address this issue administratively rather than place the burden on local contractors.

Reference Number:	2001-7-2
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0005CA5028; 1999 05-0105CA5028; 2000
Category of Finding:	Matching
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to matching:

Under the United States Code, Title 42, Section 1396 et seq. and related federal regulations, the federal government will pay a portion of the claims for allowable costs of services provided to eligible individuals. The Department of Health Services (Health Services) reviews Medicaid claims from service providers and then obtains federal funds to cover the federal government's portion of approved costs. From October 1, 1999, through September 30, 2000, the applicable federal portion for California was 51.67 percent. From October 1, 2000, through September 30, 2001, the rate was 51.25 percent.

CONDITION

Health Services does not always apply the correct federal rate for Medicaid claims. Specifically, for $582.6 million in claims filed during fiscal year 2000-01 for services provided between October 1, 2000, and June 30, 2001, Health Services applied a rate of 51.67 percent rather than the approved rate of 51.25 percent. As a result, Health Services overcharged the federal government nearly $2.4 million for its share of the claims. Health Services used the incorrect rate because its staff neglected to update the rate at the start of the new federal fiscal year, and management's review did not identify the discrepancy.

RECOMMENDATIONS

Health Services should ensure that it applies the correct federal rate when drawing down federal funds for Medicaid claims. Further, it should identify claims that it incorrectly processed, recalculate the proper amount that the federal government should have paid, and reimburse the federal government for the overpayments.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. It stated that it would implement a new procedure for communicating updated Medicaid rates to its staff. Further, Health Services stated that it will ensure that any overpayments of federal funds are offset by other fund sources when it closes out its accounting for fiscal year 2000-01. If an overpayment remains after closure, Health Services will reimburse the federal government.

Reference Number:	2001-9-2
Category of Finding:	Suspension and Debarment
State Administering Department:	Department of Health Services

(See listing of the specific federal program details following the discussion of the issues below.)

CRITERIA

Our review of federal programs identified the following compliance requirements related to suspension and debarment:

The Code of Federal Regulations, Title 45, Section 76.225, prohibits the State from knowingly doing business with any party that is suspended, debarred, or otherwise ineligible to participate in federal assistance programs. Further, Section 76.510 requires the State to obtain signed certifications from participating organizations regarding debarment, suspension, ineligibility, and voluntary exclusion.

CONDITION

The Department of Health Services (Health Services) did not always obtain the required suspension and debarment certifications from its subrecipients during fiscal year 2000-01. Specifically, it did not require the certifications from the 32 subrecipients that we reviewed that participated in the Immunization Grants program, nor from the 10 subrecipients that we reviewed who participated in the HIV Care Formula Grants program. Further, Health Services failed to obtain the suspension and debarment certifications from 3 of the 15 subrecipients that we reviewed that participated in the Maternal and Child Health Services Block Grant to the States program. When Health Services does not obtain the required certifications, it risks unknowingly allowing suspended or debarred parties to participate in the federal programs. For the transactions we reviewed, we used an alternative test to determine that these participants were not suspended or debarred.

As part of our work, we reviewed the contracts used by the Immunization Grants and HIV Care Formula Grants programs for fiscal year 2001-02. We observed that these programs included a suspension and debarment certification as part of their newer contracts.

RECOMMENDATION

Health Services should ensure that it obtains suspension and debarment certifications from all subrecipients of federal program funds.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. Although Health Services has developed a procedure for obtaining the required suspension and debarment certifications, it is in the early stages of implementation. To ensure that all certifications are obtained and that it follows its procedures, Health Services plans to coordinate with other branches in the department that receive federal program funds to ensure that they include the correct language and follow updated procedures.

U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Federal Catalog Number:	93.268
Federal Program Title:	Immunization Grants
Federal Award Numbers and Calendar Years Awarded:	H23/CCH904423-10-15; 1999 H23/CCH904423-11-8; 2001

Federal Catalog Number:	93.917
Federal Program Title:	HIV Care Formula Grants
Federal Award Numbers and Calendar Years Awarded:	5X07HA00041-10; 2000 2X07HA00041-11; 2001

Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Numbers and Calendar Years Awarded:	6B04MC00336-03; 1999 6B04MC00336-04; 2000

Reference Number:	2001-12-1
Federal Catalog Number:	93.994
Federal Program Title:	Maternal and Child Health Services Block Grant to the States
Federal Award Numbers and Calendar Years Awarded:	6B04MC00336-03; 1999 6B04MC00336-04; 2000

Category of Finding: Reporting

State Administering Department: Department of Health Services

CRITERIA

Our review of the Maternal and Child Health Services Block Grant to the States program (program) determined that the following compliance requirements apply to reporting:

The United States Code, Title 42, Section 706(a), requires the State to prepare and submit an annual report concerning its program activities. This annual report must contain accurate information pertaining to the description of such activities, a complete record of the purposes for which the funds were spent, and a description of the extent to which the State has met certain program goals. Additionally, federal guidelines for completing the report instruct the State to make an estimate if an actual number is unavailable and to explain all estimates in a footnote.

CONDITION

The Department of Health Services (Health Services) does not always report complete information in its annual program report to the U.S. Department of Health and Human Services (HHS). Specifically, Health Services does not identify and explain that it estimated some of the expenditures and other amounts in its annual report. For example, although Health Services reported spending $1.12 billion for fiscal year 1998-99 program activities, it did not identify and explain that it derived this amount using estimates for several program components, including $374.5 million from its Children's Medical Services Branch. Additionally, Health Services used predetermined percentages to estimate certain expenditures by the types of individuals served and by the types of services provided. Similarly, because it used a flawed methodology, Health Services submitted an incorrect estimate of the number of HIV cases in California needing and receiving treatment. To estimate this number, Health Services multiplied its estimation of the number of confirmed HIV cases in California by a percentage that bears no relationship to the population the department was attempting to identify. Further, in reporting the primary sources of insurance coverage for infants less than 1 year of age and for children 1 to 22 years of age, Health Services used data from its Child Health and Disability Prevention program report that was based upon estimates. Finally, in reporting the primary sources of insurance coverage for children with special health care needs, Health Services used average caseloads from county administrative claims to estimate the number of children served.

When Health Services does not identify and explain all estimates that it uses in its annual report to the federal government, HHS may be unable to make a sound assessment of its success in enhancing the well-being of mothers and children served by the program.

As part of our work, we also reviewed Health Services' annual report for the next fiscal year—1999-2000. We observed that Health Services added new footnotes explaining its use of estimates to derive some expenditures and other amounts. It also ceased estimating the number of HIV cases in California that needed and received treatment. However, Health Services' use of other estimates continues to be unexplained.

RECOMMENDATION

Health Services should identify and explain all estimates it uses in its annual report to HHS.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services agrees with the recommendation. It said that when it prepares future annual reports to the federal government, it will fully disclose and explain all estimates used by the different programs providing input into the report.

Reference Number:	2001-12-6
Federal Catalog Number:	93.568
Federal Program Title:	Low-Income Home Energy Assistance
Federal Award Number and Calendar Year Awarded:	G-00B1CALIEA; 1999
Category of Finding:	Reporting
State Administering Department:	Department of Community Services and Development

CRITERIA

Our review of the Low-Income Home Energy Assistance program determined that the following are among the compliance requirements for reporting:

The Code of Federal Regulations, Title 45, Section 96.82, requires the State to submit annually to the U.S. Department of Health and Human Services (HHS) the data required by the United States Code, Title 42, Section 8624(c)(1)(G) for the 12-month period corresponding to the federal fiscal year. Under the requirements of Section 8624(c)(1)(G), the State must prepare and submit a plan that reports the number and income levels of households that apply for assistance and the number that are

assisted with federal funds. Further, the State must report the number of households assisted that have one or more members who are at least 60 years of age, have one or more members who are disabled, and have one or more young children.

CONDITION

In its January 2001 report to HHS, the Department of Community Services and Development (Community Services) did not accurately report for the Low-Income Home Energy Assistance program the number of households it served during the federal fiscal period covering October 1, 1999, through September 30, 2000, and the demographics of these households. Specifically, Community Services failed to include in its report the data for services provided during certain periods. The information was mistakenly omitted and Community Services' management review did not detect the omission. As a result, Community Services underreported the services it provided in nearly every category. For example, it understated by at least 1,330 households the number of households assisted under the Home Energy Assistance component of the program.

RECOMMENDATION

Community Services should ensure it accurately reports assistance activity to HHS.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Community Services will take greater care, in the future, to ensure that all information is accurately submitted.

Reference Number:	2001-14-4
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0005CA5028; 1999 05-0105CA5028; 2000
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to medical service providers:

The Code of Federal Regulations, Title 42, Section 431.107, requires the State to provide for an agreement between the state agency administering the Medicaid program and each provider. The provider must agree to disclose certain information, including any significant ownership or controlling interest in any other entity that is paid Medicaid funds, as outlined in sections 455.103 through 455.106. Further, Section 455.104 requires providers to update their disclosures when their facilities are surveyed or agreements are renewed.

CONDITION

The Department of Health Services (Health Services) does not have adequate controls over provider agreements. Specifically, our review of 30 provider files revealed that Health Services could not locate agreements for 8 of these providers. Further, although Health Services had on file at least an application for 29 of the 30 providers, it could not locate any disclosure information for one provider. Although we identified a similar weakness during our audit of the prior year, the number of sampled providers with missing documents is lower this year. During our audit of fiscal year 1999-2000, Health Services could not locate agreements for 24 of the 31 providers we reviewed and could not locate any disclosure information for 5 providers.

When Health Services cannot demonstrate that it obtained the required provider agreements and disclosures, it cannot ensure that it made Medicaid claim payments only to authorized providers.

Health Services said it has developed an expanded provider agreement and is continuing the process of re-enrolling existing providers. Because approximately 140,000 providers exist, Health Services prioritized its re-enrollment process and started re-enrolling higher-risk providers in June 1999. Health Services estimates that it has re-enrolled nearly 600 providers and placed another 900 on inactive status.

RECOMMENDATION

Health Services should continue with its re-enrollment process of renewing provider files so that provider agreements, disclosure of significant beneficial interest, and other pertinent provider information is reasonably current.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

Health Services concurs with the finding. It stated that it has instituted the following activities to help resolve the issue:

- Initiated preliminary discussions with the Licensing and Certification Program to incorporate provider agreements into the acute care enrollment process.
- Continue the re-enrollment process so that provider agreements and disclosure of significant beneficial interest are reasonably current. Health Services is currently giving priority to higher-risk providers.
- Place on inactive status those providers that have not billed for services for 12 months.

Reference Number:	2001-14-5
Federal Catalog Number:	93.778
Federal Program Title:	Medical Assistance Program
Federal Award Numbers and Calendar Years Awarded:	05-0005CA5028; 1999 05-0105CA5028; 2000
Category of Finding:	Special Tests and Provisions
State Administering Department:	Department of Health Services

CRITERIA

Our review of the Medical Assistance Program (Medicaid) identified the following compliance requirements related to payment rates for service providers:

The Code of Federal Regulations, Title 42, Section 447.253(b)(1), requires Medicaid payments for services provided by long-term care facilities to be based on rates that are reasonable and adequate to meet costs incurred by economically and efficiently operated providers in order to provide services conforming with laws, regulations, and standards. Further, Section 447.253(i) states that the rates must be determined according to the methods and standards specified in the federally approved Medicaid State Plan (state plan). To set reasonable and adequate rates as required by the Code of Federal Regulations, the state plan requires the Department of Health Services (Health Services) to annually perform a rate study. As part of this rate

study, Health Services uses information from cost reports filed by service providers. To verify the accuracy of the amounts reported, the state plan requires Health Services to audit a sample of the cost reports submitted.

CONDITION

When calculating the payment rates effective August 2001 for long-term care facilities that treat developmentally disabled individuals (LTC facilities), Health Services audited far fewer cost reports than it would have audited had it followed its established methodology. Specifically, Health Services audited only 146 cost reports for LTC facilities, 327 fewer reports than the 473 called for based on the state plan and on Health Services' sample-setting methodology. The state plan calls for the sample size to be a minimum of 15 percent of the total number of cost reports submitted and large enough to meet certain statistical expectations (statistical amount). To calculate the statistical amount, Health Services uses a mathematical formula, a portion of which relies on the results of the most recently available cost report audits. For example, when determining the payment rates for use beginning August 2001, Health Services would use the audit results of cost reports covering fiscal periods ending in 1999 in its mathematical formula.

Health Services did not audit its full complement of cost reports for the LTC facilities because, after it calculated the sample size, it concluded that it did not have sufficient staff to perform the work. Rather than obtaining additional resources or requesting approval from the U.S. Department of Health and Human Services to deviate from the state plan's provisions concerning sample size, Health Services subsequently reduced the sample size to 146 by relying on information from cost reports covering an earlier fiscal period. We recognize that for one type of LTC facility, the sample size that Health Services used was more than twice as large as those it used in previous years. For another type of facility, the sample size was comparable to that of previous years.

Because it did not audit the number of cost reports required by the state plan's provisions and according to its past practices, Health Services has less assurance that the rates it developed for LTC facilities are reasonable and adequate to meet costs incurred by service providers. If, for instance, the rates are lower than they otherwise would have been had Health Services performed the required number of cost report audits, service providers will not earn amounts sufficient to cover their costs. On the other hand, if the rates are higher than they otherwise would have been, the state and federal governments could pay service providers more than they should receive. Although Health Services does not believe the reduction in the number of cost report audits performed materially affected rates, it provided no substantive analyses to support its position.

RECOMMENDATIONS

Health Services should determine conclusively whether the number of cost reports from LTC facilities that it audited is large enough to meet the statistical expectations of the state plan. If the sample size is not large enough, Health Services should request approval from the U.S. Department of Health and Human Services to deviate from the state plan's provisions concerning sample size.

DEPARTMENT'S VIEW AND CORRECTIVE ACTION PLAN

With respect to the two types of facilities, Health Services disagrees with the finding that it did not audit the number of cost reports as required by the state plan's provisions and according to its past practices. While Health Services audited fewer cost reports than what was selected, it believes that it complied with the state plan. Specifically, it audited 15 percent of the population of cost reports, and it believes that the state plan can be interpreted to mean that a 15 percent sample is sufficiently large enough to reasonably expect audit results and a class audit adjustment factor representative of the class of facilities for which it will be used during the annual rate-setting process. Moreover, Health Services states that the number of cost reports actually audited (146 cost reports), as opposed to the sample size selected (395 cost reports) is significantly higher than the number of cost reports audited in previous years.

Health Services also points out that the class audit adjustment for the one type of LTC facility derived from the sample in question was .9655, whereas the class audit adjustment for the previous year was .93852. The class audit adjustment for the other type of facility derived from the sample in question was .94061, whereas the class audit adjustment for the previous year was .94603. Therefore, Health Services maintains, the adjustments derived from the sample in question were, in effect, within reason. Notwithstanding the above, Health Services is committed to revising, based on the concerns identified in the audit, the language in the state plan addressing the sampling methodology for the selection of facilities to be field-audited.

AUDITEE’S SECTION

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Schedule of Federal Assistance

Prepared by
Department of Finance

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STATE OF CALIFORNIA
SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 2001

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Department of Agriculture		
Market Protection and Promotion	10.163	111,680
Farm Labor Housing Loans and Grants	10.405	500,000
Rural Housing Preservation Grants	10.433	761,741
Food Distribution	10.550	98,698,357 *
Special Supplemental Food Program for Women, Infants, and Children	10.557	718,343,689
Child and Adult Care Food Program	10.558	194,766,897
State Administrative Expenses for Child Nutrition	10.560	16,069,261
Commodity Supplemental Food Program	10.565	2,298,770
Nutrition Program for the Elderly	10.570	10,824,581
WIC Farmers' Market Nutrition Program (FMNP)	10.572	3,792,670
Team Nutrition Grants	10.574	144,621
Cooperative Forestry Assistance	10.664	1,430,036
National Forest-Dependent Rural Communities	10.670	257,360
Other - U.S. Department of Agriculture	10.999	8,411,606
Total Excluding Clusters		1,056,411,269
Food Stamp Cluster		
Food Stamps	10.551	1,576,288,377 *
State Administrative Matching Grants for Food Stamp Program	10.561	273,988,098
Total Food Stamp Cluster		1,850,276,475
Child Nutrition Cluster		
School Breakfast Program	10.553	196,564,508
National School Lunch Program	10.555	760,939,147
Special Milk Program for Children	10.556	764,910
Summer Food Service Program for Children	10.559	18,302,763
Total Child Nutrition Cluster		976,571,328
Emergency Food Assistance Cluster		
Emergency Food Assistance Program	10.568	5,687,785
Emergency Food Assistance (commodities)	10.569	32,286,554 *
Total Emergency Food Assistance Cluster		37,974,339

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Research & Development Cluster		
Federal-State Marketing Improvement Program	10.156	49,100
Market Protection and Promotion	10.163	23,906
Cooperative Forestry Assistance	10.664	122,392
Total Research & Development Cluster		195,398
Schools and Roads Cluster		
Schools and Roads - Grants to States	10.665	26,422,003
Total U.S. Department of Agriculture		3,947,850,812
Department of Commerce		
Economic Development-Support for Planning Organizations	11.302	150,000
Economic Adjustment Assistance	11.307	199,535
Sudden and Severe Economic Dislocation	11.311	8,889,063 ***
Anadromous Fish Conservation Act Program	11.405	322,880
Interjurisdictional Fisheries Act of 1986	11.407	132,397
Coastal Zone Management Administration Awards	11.419	2,776,968
Coastal Zone Management Estuarine Research Reserves	11.420	564,309
Marine Sanctuary Program	11.429	37,281
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438	430,585
Habitat Conservation	11.463	330,560
Office of Administration Special Programs	11.470	31,288
Technology Opportunities	11.552	95,372
Other - U.S. Department of Commerce	11.999	85,716
Total U.S. Department of Commerce		14,045,954
Department of Defense		
Planning Assistance to States	12.110	480,185
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113	11,983,871
National Guard Military Operations and Maintenance (O&M) Projects	12.401	40,677,303
Community Economic Adjustment Planning Assistance	12.607	32,903
Total U.S. Department of Defense		53,174,262
Department of Housing and Urban Development		
Manufactured Home Construction and Safety Standards	14.171	167,200
Community Development Block Grants/State's Program	14.228	39,460,473

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Emergency Shelter Grants Program	14.231	5,398,907
Supportive Housing Program	14.235	5,221,949 ***
HOME Investment Partnerships Program	14.239	74,931,819 ***
Housing Opportunities for Persons with AIDS	14.241	2,557,330
Equal Opportunity in Housing	14.400	985,150
Lead-Based Paint Hazard Control Priority Housing	14.900	1,008,236
Total Excluding Clusters		129,731,064
Section 8 Project-Based Cluster		
Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation	14.856	110,274
Section 8 Tenant-Based Cluster		
Section 8 Rental Voucher Program	14.855	2,795,043
Section 8 Rental Certificate Program	14.857	292,868
Total Section 8 Tenant-Based Cluster		3,087,911
Total U.S. Department of Housing and Urban Development		132,929,249
Department of the Interior		
Recreation Resource Management	15.225	721
Small Reclamation Projects	15.503	328,048
Anadromous Fish Conservation	15.600	79,470
Endangered Species Conservation	15.612	404,119
Coastal Wetlands Planning, Protection and Restoration Act	15.614	118,984
Cooperative Endangered Species Conservation Fund	15.615	460,950
Clean Vessel Act	15.616	280,000
Wildlife Conservation and Appreciation	15.617	6,476
Administrative Grants for Federal Aid in Sport Fish and Wildlife Restoration	15.618	419,926
Geological Survey-Research and Data Acquisition	15.808	137,454
Historic Preservation Fund Grants-In - Aid	15.904	891,993
Outdoor Recreation-Acquisition, Development and Planning	15.916	1,339,440
National Maritime Heritage Grants	15.925	18,815
Research Information	15.975	895,625
Other - U.S. Department of the Interior	15.999	40,564,316
Total Excluding Clusters		45,946,337
Fish and Wildlife Cluster		
Sport Fish Restoration	15.605	10,596,654
Wildlife Restoration	15.611	5,763,706
Total Fish and Wildlife Cluster		16,360,360

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Research and Development Cluster		
Anadromous Fish Conservation	15.600	11,810
Coastal Wetlands Planning, Protection and Restoration Act	15.614	30,593
Total Research and Development Cluster		42,403
Total U.S. Department of the Interior		62,349,100
Department of Justice		
State Domestic Preparedness Equipment Support Program	16.007	36,337
Juvenile Accountability Incentive Block Grants	16.523	21,161,257
Juvenile Justice and Delinquency Prevention-Allocation to States	16.540	8,730,860
Juvenile Justice and Delinquency Prevention-Special Emphasis	16.541	2,681,107
Part E-State Challenge Activities	16.549	638,706
National Criminal History Improvement Program	16.554	3,496,761
National Sex Offender Registry Assistance	16.555	282,281
Criminal Justice Discretionary Grant Program	16.574	1,137,478
Crime Victim Assistance	16.575	34,347,876
Crime Victim Compensation	16.576	19,161,000
Byrne Formula Grant Program	16.579	53,508,771
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580	31,301
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	24,987,668
Violence Against Women Formula Grants	16.588	17,625,137
Rural Domestic Violence and Child Victimization Enforcement Grant Program	16.589	242,738
Grants to Encourage Arrest Policies and Enforcement of Protection Orders	16.590	181,964
Local Law Enforcement Block Grants Program	16.592	2,370,968
Residential Substance Abuse Treatment for State Prisoners	16.593	4,912,967
Tuberculosis Prevention Diagnosis and Treatment Program	16.594	35,774
State Identification Systems Grant Program	16.598	115,656
Corrections-Technical Assistance/Clearinghouse	16.603	175,528
State Criminal Alien Assistance Program	16.606	195,851,999
Bulletproof Vest Partnership Program	16.607	490,375
Regional Information Sharing Systems	16.610	2,891,542
Public Safety Partnership and Community Policing Grants ("COPS" Grants)	16.710	11,313,180
Other - U.S. Department of Justice	16.999	1,569,396
Total Excluding Clusters		407,978,627

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Research and Development Cluster		
Violence Against Women Formula Grants	16.588	55,534
Total U.S. Department of Justice		408,034,161
Department of Labor		
Labor Force Statistics	17.002	6,432,336
Compensation and Working Conditions Data	17.005	246,709
Labor Certification for Alien Workers	17.203	5,717,161
Unemployment Insurance	17.225	2,980,142,166
Senior Community Service Employment Program	17.235	7,249,191
Trade Adjustment Assistance-Workers	17.245	10,561,878
Employment Services and Job Training - Pilot and Demonstration Programs	17.249	88,454
Welfare-to-Work Grants to States and Localities	17.253	103,773,722
Workforce Investment Act	17.255	302,822,528
Occupational Safety and Health	17.500	403,635
Occupational Safety and Health-State Program	17.503	22,416,306
Consultation Agreements	17.504	6,230,442
Mine Health and Safety Grants	17.600	248,411
Veterans' Employment Program	17.802	1,244,331
Other-U.S. Department of Labor	17.999	1,167,404
Total Excluding Clusters		3,448,744,674
Employment Services Cluster		
Employment Service	17.207	106,332,702
Disabled Veterans' Outreach Program	17.801	11,843,921
Local Veterans' Employment Representative Program	17.804	6,675,886
Total Employment Services Cluster		124,852,509
JTPA Cluster		
Employment and Training Assist-Dislocated Workers	17.246	75,138,333
Job Training Partnership Act	17.250	67,459,814
Total JTPA Cluster		142,598,147
Total U.S. Department of Labor		3,716,195,330
Department of Transportation		
Boating Safety Financial Assistance	20.005	2,037,209
Airport Improvement Program	20.106	185,062
Motor Carrier Safety	20.217	5,468,441

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Local Rail Freight Assistance	20.308	1,454,013
Federal Transit-Metropolitan Planning Grants	20.505	39,551,167
Public Transportation for Nonurbanized Areas	20.509	11,293,351
Pipeline Safety	20.700	2,358,636
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703	922,055
Other-U.S. Department of Transportation	20.999	634,597
Total Excluding Clusters		63,904,531
Highway Planning and Construction Cluster		
Highway Planning & Construction	20.205	1,729,993,539 ***
Federal Transit Cluster		
Federal Transit Capital Improvement Grants	20.500	4,587,476
Highway Safety Cluster		
State & Community Highway Safety	20.600	37,359,063
Research and Development Cluster		
Highway Planning & Construction	20.205	21,319,119
Total U.S. Department of Transportation		1,857,163,728
Department of Treasury		
Other -U.S. Department of Treasury	21.999	263,919
Equal Employment Opportunity Commission		
Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	30.002	3,056,850
General Services Administration		
Donation of Federal Surplus Personal Property	39.003	6,866,940 **
National Aeronautics and Space Administration		
Technology Transfer	43.002	105,514
National Foundation on the Arts and the Humanities		
Promotion of the Arts-State and Regional Program	45.007	836,800
State Library Program	45.310	14,972,427
Total National Foundation on the Arts and Humanities		15,809,227

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Small Business Administration		
Small Business Development Center	59.037	8,702,771
Department of Veterans Affairs		
Grants to State for Construction of States Home Facilities	64.005	5,854,987
Veterans State Domiciliary Care	64.014	5,398,941
Veterans State Nursing Home Care	64.015	6,186,853
Veterans State Hospital Care	64.016	119,515
All Volunteer Force Educational Assistance	64.124	54,478
Other-U.S. Department of Veterans Affairs	64.999	959,037
Total U.S. Department of Veteran's Affairs		18,573,811
Environmental Protection Agency		
Air Pollution Control Program Support	66.001	7,414,911
Air Pollution Control - National Ambient Air and Source Emission Data	66.007	55,263
State Indoor Radon Grants	66.032	213,338
Water Pollution Control-State and Interstate Program Support	66.419	4,084,384
State Underground Water Source Protection	66.433	333,065
Construction Management Assistance	66.438	13,657
Water Quality Management Planning	66.454	708,265
National Estuary Program	66.456	217,727
Capitalization Grants for State Revolving Funds	66.458	1,264,260,908 ***
Nonpoint Source Implementation Grants	66.460	7,112,172
Wetlands Grants	66.461	491,744
Water Quality Cooperative Agreements	66.463	671,686
Near Coastal Waters	66.464	45,266
Capitalization Grants for Drinking Water State Revolving Fund	66.468	77,506,142 ***
Hardship Grants for Rural Communities	66.470	706,455
Safe Drinking Water Research and Demonstration	66.506	3,528,952
Toxic Substances Research	66.507	219,506
Surveys, Studies, Investigations and Special Purpose Grants	66.606	827,913
Consolidated Pesticide Enforcement Cooperative Agreements	66.700	1,192,684
Toxic Substances Compliance Monitoring Cooperative Agreements	66.701	104,319
TSCA Title IV State Lead Grants-Certification of Lead-Based Paint Professionals	66.707	399,862
Pollution Prevention Grants Program	66.708	53,593
Hazardous Waste Management State Program Support	66.801	8,039,588

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Superfund State Site-Specific Cooperative Agreements	66.802	1,968,485
State and Tribal Underground Storage Tanks Program	66.804	370,197
Leaking Underground Storage Tank Trust Fund Program	66.805	2,835,559
Solid Waste Management Assistance	66.808	106,654
CEPP Technical Assistance Grants Program	66.810	50,000
Brownfield Pilots Cooperative Agreements	66.811	150,463
U.S.-Mexico Border Grants Program	66.930	150,000
Other-U.S. Environmental Protection Agency	66.999	8,376
Total Excluding Clusters		1,383,841,134
Research and Development Cluster		
Wetlands Protection-State and Tribal Development Grants	66.461	82,201
Consolidated Pesticide Enforcement Cooperative Agreements	66.700	33,557
Pollution Prevention Grants Program	66.708	97,904
Other-U.S. Environmental Protection Agency	66.999	46,815
Total Research and Development Cluster		260,477
Total U.S. Environmental Protection Agency		1,384,101,611
Department of Energy		
State Energy Conservation	81.041	3,422,006
Weatherization Assistance for Low-Income Persons	81.042	3,081,444
Conservation Research and Development	81.086	12,588
Environmental Restoration	81.092	657,595
National Industrial Competitiveness through Energy, Environment, and Economics	81.105	849,759
Total Department of Energy		8,023,392
Federal Emergency Management Agency		
Hazardous Materials Training Program for Implementation of the Superfund Amendment and Reauthorization Act of 1986	83.011	163,367
State Disaster Preparedness Grants	83.505	160,979
Earthquake Hazards Reduction Grants	83.521	186,858
Emergency Management-State and Local Assistance	83.534	677,311
Mitigation Assistance	83.535	52,863
Flood Mitigation Assistance	83.536	162,079
Individual and Family Grants	83.543	311,000
Public Assistance Grants	83.544	399,222,804
Hazard Mitigation Grant	83.548	115,373,221
Project Impact: Building Disaster Resistant Communities	83.551	3,182

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Emergency Management Performance Grants	83.552	10,126,229
Other - Federal Emergency Management Agency	83.999	450,230
Total Excluding Clusters		526,890,123
Research and Development Cluster		
Earthquake Hazards Reduction Grants	83.521	58,809
Emergency Management Performance Grants	83.552	600,600
Other - Federal Emergency Management Agency	83.999	309,000
Total Research and Development Cluster		968,409
Total Federal Emergency Management Agency		527,858,532
Department of Education		
Adult Education-State Grant Program	84.002	39,776,161
Title I Grants to Local Educational Agencies	84.010	972,974,068
Migrant Education-Basic State Grant Program	84.011	106,801,142
Title I Program for Neglected and Delinquent Children	84.013	3,527,848
Services for Children with Deaf-Blindness	84.025	307
Special Education-Personnel Development and Parent Training	84.029	198
Vocational Education-Basic Grants to States	84.048	106,513,332
Vocational Education-State Councils	84.053	302,956
Leveraging Educational Assistance Partnership	84.069	6,452,451
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	237,921,553
Rehabilitation Services-Service Projects	84.128	929,775
Public Library Construction and Technology Enhancement	84.154	808,389
Immigrant Education	84.162	33,292,857
Independent Living-State Grants	84.169	1,869,076
Rehabilitation Services-Independent Living Services for Older Individual Who are Blind	84.177	344,507
Special Education-Grants for Infants and Families with Disabilities	84.181	58,758,435
Byrd Honors Scholarships	84.185	8,698,625
Safe and Drug-Free Schools-State Grants	84.186	52,894,718
Supported Employment Services for Individuals with Severe Disabilities	84.187	2,353,334
Bilingual Education Support Services	84.194	1,298,188
Bilingual Education - Professional Development	84.195	141,000
Education for Homeless Children and Youth	84.196	2,834,011
Even Start-State Educational Agencies	84.213	14,689,221
Fund for the Improvement of Education	84.215	435,319
Capital Expenses	84.216	2,196,598
Assistive Technology	84.224	1,343,545

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Tech-Prep Education	84.243	9,239,087
Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	84.265	383,004
Goals 2000-State and Local Education Systematic Improvement Grants	84.276	36,759,369
School to Work Opportunities	84.278	32,559,644
Eisenhower Professional Development State Grants	84.281	36,969,670
Charter Schools	84.282	13,326,648
Innovative Education Program Strategies	84.298	43,747,551
Even Start-Statewide Family Literacy Program	84.314	23,886
Technology Literacy Challenge Fund Grants	84.318	37,259,725
Special Education-State Program Improvement Grants for Children with Disabilities	84.323	1,564,259
Advanced Placement Incentive Program	84.330	375,959
Grants to States for Incarcerated Youth Offenders	84.331	1,170,379
Comprehensive School Reform Demonstration	84.332	15,385,842
Teacher Quality Enhancement Grants	84.336	1,002,859
Class Size Reduction	84.340	134,121,387
Preparing Tomorrow's Teachers to Use Technology	84.342	270,441
Title I Accountability Grants	84.348	16,324,061
Total Excluding Clusters		2,037,641,385
Student Financial Aid Cluster		
Federal Family Education Loans	84.032	16,599,808,011 ***
Special Education Cluster		
Special Education-Grants to States	84.027	498,925,541
Special Education-Preschool Grants	84.173	23,266,370
Total Special Education Cluster		522,191,911
Total U.S. Department of Education		19,159,641,307
Consumer Product Safety Commission		
Other-Consumer Product Safety Commission	87.999	56,623
Department of Health and Human Services		
Public Health and Social Services Emergency Fund	93.003	32,212
Special Programs for the Aging-Title VII, Chapter 3-Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041	458,113
Special Programs for the Aging-Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	93.042	839,296

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Special Programs for the Aging-Title III, Part F-Disease Prevention and Health Promotion Services	93.043	1,720,745
Special Programs for the Aging-Title III, Part D-In-Home Services for Frail Older Individuals	93.046	12
Special Programs for the Aging-Title IV, Training, Research and Discretionary Projects and Programs	93.048	179,853
Grants for Residential Treatment Programs for Pregnant and Postpartum Women	93.101	724,557
Demonstration Grants for Residential Treatment for Women and Their Children	93.102	353,846
Food and Drug Administration-Research	93.103	2,045,584
Maternal and Child Health Federal Consolidated Programs	93.110	96,631
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	7,489,560
Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services Technical Assistance Centers for Evaluation	93.119	42,520
Emergency Medical Services for Children	93.127	91,374
Primary Care Services - Resource Coordination and Development Primary Care Offices	93.130	402,650
Injury Prevention and Control Research and State and Community Based Programs	93.136	133,668
Projects for Assistance in Transition from Homelessness	93.150	3,841,410
Health Program for Toxic Substances and Disease Registry	93.161	948,164
Grants for State Loan Repayment	93.165	767,366
Cooperative Agreements for Drug Abuse Treatment Improvement Projects in Target Cities	93.196	1,323,493
Demonstration Cooperative Agreements for Development and Implementation of Criminal Justice Treatment Networks	93.229	685,852
Traumatic Brain Injury-State Demonstration Grant Program	93.234	32,251
Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	93.238	532,553
Childhood Immunization Grants	93.268	147,192,772 *
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	2,783,201
Promoting Safe and Stable Families	93.556	32,982,224
Temporary Assistance for Needy Families	93.558	4,204,719,293
Family Support Payments to States-Assistance Payments	93.560	26,400
Child Support Enforcement	93.563	118,224,158
Refugee and Entrant Assistance-State Administered Programs	93.566	33,338,873
Low-Income Home Energy Assistance	93.568	85,752,839
Community Services Block Grant	93.569	52,220,720
Community Services Block Grant - Discretionary Award	93.570	44,462
Community Services Block Grant Discretionary Awards-Community Food and Nutrition	93.571	454,498

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Refugee and Entrant Assistance-Discretionary Grants	93.576	5,633,900
Repatriation Program	93.579	14,193
Refugee and Entrant Assistance-Targeted Assistance	93.584	7,850,656
Empowerment Zones Program	93.585	3,586,422
Community-Based Family Resource and Support Grants	93.590	3,184,160
Welfare Report Research, Evaluations and National Studies	93.595	102,191
Grants to States for Access and Visitation Programs	93.597	876,151
Head Start	93.600	171,963
Child Support Enforcement Demonstrations and Special Projects	93.601	61,200
Adoption Incentive Payments	93.603	1,870,547
Developmental Disabilities Basic Support and Advocacy Grants	93.630	4,613,839
Children's Justice Grants to States	93.643	832,617
Child Welfare Services-State Grants	93.645	33,917,703
Adoption Opportunities	93.652	249,054
Foster Care-Title IV-E	93.658	1,192,113,549
Adoption Assistance	93.659	175,468,738
Social Services Block Grant	93.667	218,686,277
Child Abuse and Neglect State Grants	93.669	4,487,247
Family Violence Prevention and Services/Grants for Battered Women's Shelters_Grants to States and Indian Tribes	93.671	9,055,319
Independent Living	93.674	21,523,444
State Children's Insurance Program	93.767	259,842,527
Medicare-Supplementary Medical Insurance	93.774	8,443,303
Health Care Financing and Research, Demonstrations and Evaluations	93.779	1,045,022
Model Comprehensive Drug Abuse Treatment Programs for Critical Populations	93.902	501
Grants to States for Operation of Offices of Rural Health	93.913	288,908
HIV Care Formula Grants	93.917	110,713,389
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Program	93.919	4,884,472
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	1,003,071
HIV Prevention Activities: Health Department Based	93.940	10,643,394
HIV Demonstration, Research, Public and Professional Education Projects	93.941	206,289
Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	93.943	494,057
Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	93.944	1,451,551
Assistance Program for Chronic Disease Prevention and Control	93.945	335,893

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Demonstration Grants to States with Respect to Alzheimer's Disease	93.951	185,263
Block Grants for Community Mental Health Services	93.958	43,599,612
Block Grants for Prevention and Treatment of Substance Abuse	93.959	259,995,321
Preventive Health Services-Sexually Transmitted Disease Control Grants	93.977	3,528,832
Preventive Health Services- Sexually Transmitted Diseases Research, Demonstrations, and Public Information and Education Grants	93.978	866,603
Mental Health Disaster Assistance and Emergency Mental Health	93.982	71,181
Health Program for Refugees	93.987	926,987
Cooperative Agreements for State-Based Diabetes Control Program and Evaluation of Surveillance Systems	93.988	243,903
Preventive Health and Health Services Block Grant	93.991	15,289,484
Maternal and Child Health Services Block Grant to the States	93.994	35,251,306
Other-Department of Health and Human Services	93.999	12,757,353
Total Excluding Clusters		7,156,848,542
Aging Cluster		
Special Programs for the Aging-Title III, Part B-Grants for Supportive Services and Senior Centers	93.044	28,847,989
Special Programs for the Aging-Title III, Part C-Nutrition Services	93.045	46,978,002
Total Aging Cluster		75,825,991
Child Care Cluster:		
Child Care and Development Block Grant	93.575	462,628,427
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	269,048,961
Total Child Care Cluster		731,677,388
Medicaid Cluster		
State Medicaid Fraud Control Units	93.775	10,593,241
State Survey and Certification of Health Care Providers and Suppliers	93.777	23,103,580
Medical Assistance Program	93.778	13,261,920,047
Total Medicaid Cluster		13,295,616,868
Total U.S. Department of Health and Human Services		21,259,968,789
Corporation for National and Community Service		
State Commission(s)	94.003	1,334,743
Learn and Serve America-School and Community Based Programs	94.004	2,692,390
AmeriCorps	94.006	24,219,295
Total Excluding Clusters		28,246,428

Federal Agency/Program Title	Federal Catalog Number	Grant Amount Received
Foster Grandparent/Senior Companion Cluster:		
Foster Grandparent Program	94.011	1,412,387
Total Corp. for National and Community Service		29,658,815
Social Security Administration		
Disability Insurance/SSI Cluster		
Social Security-Disability Insurance	96.001	173,403,979
Office Of National Drug Control Policy		
High Intensity Drug Trafficking Area	See Note 4	3,745,885
Miscellaneous Grants and Contracts		
Shared Revenue-Flood Control Lands	98.002	332,907
Shared Revenue-Grazing Land	98.004	173,469
Capital Outlay - Reed Act	98.012	33,974,195
U.S. Department of the Interior-Fire Prevention/Suppression Agreement	98.014	134,000
U.S. Department of the Interior-Fire Prevention/Suppression Agreement	98.015	160,367
U.S. Department of Agriculture and Various Other U.S. Department-Fire Prevention/Suppression	98.016	54,631,667
Miscellaneous Federal Receipts	98.099	504,774
Miscellaneous Federal Receipts	98.999	2,599,388
Total Miscellaneous		92,510,767
Total Federal Awards Received		**$52,884,091,328**

* Amount includes value of commodities or food stamps.

** Amount includes donated property.

*** Amount includes loans and insurance in effect as of June 30, 2001.

NOTES TO THE SCHEDULE OF FEDERAL ASSISTANCE
FISCAL YEAR ENDED JUNE 30, 2001

1. General

The accompanying State of California Schedule of Federal Assistance presents the total amount of federal financial assistance programs received by the State of California for the fiscal year ended June 30, 2001. This schedule does not include expenditures of federal grants received by the University of California, the California State University, and the California Housing Finance Agency. The expenditures of the University of California, California State University, and California Housing Finance Agency are audited by other independent auditors 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).

The $52,884,091,328 in total federal assistance consists of the following:

Cash assistance received	$33,193,062,517
Noncash federal awards	1,849,483,576
Loans and/or loan guarantees outstanding	14,951,010,229
Insurance in-force	2,890,535,006
Total	**$52,884,091,328**

2. Basis of Accounting

OMB Circular A-133 and the Single Audit Act of 1984 (Amended 1996) require the Schedule of Federal Assistance to present total expenditures for each federal assistance program. However, although the state accounting system separately identifies revenues for each federal assistance program, it does not separately identify expenditures for each program. As a result, the State prepares its Schedule of Federal Assistance on a cash receipts basis. The schedule shows the amount of cash and noncash federal assistance received, loans and loan guarantees outstanding, and insurance in force for the year ended June 30, 2001.

3. Unemployment Insurance

Of the $2,980,142,166 in total unemployment insurance funds (federal catalog number 17.225) received by the Employment Development Department during fiscal year 2000-01, $2,662,047,204 was State Unemployment Insurance funds that were drawn down from the Unemployment Trust Fund in the U.S. Treasury.

4. Other

The California Department of Justice (DOJ) receives cash reimbursements from local law enforcement agencies under the Office of National Drug Control Policy's High Intensity Drug Trafficking Area program. During the period July 1, 2000 through June 30, 2001, the DOJ received the following cash reimbursements from pass-through entities:

Federal Agency/Program	Pass-through Entity	Grant Number	Amount
Office of National Drug Control Policy/ High Intensity Drug Trafficking Area	City of San Diego	18PSCP575	$ 65,482
		19PSCP575	523,575
		10PSCP575	1,618,779
		11PSCP575	342,345
	City of Hawthorne	18PLAP534	72,997
		19PLAP534	68,698
		10PLAP534	905,808
		18PLAP541	481
		19PLAP541	100,146
		10PLAP541	47,574
		Total	$3,745,885

The State was also loaned Federal Excess Personal Property (FEPP) from the U.S. Forest Service during the period July 1, 2000 to June 30, 2001. According to the California Department of Forestry and Fire Protection, the amount loaned from July 1, 2000 to June 30, 2001, was $3,045,725. The U.S. Forest Service and the State maintain the FEPP program at federal acquisition costs of the property.

Summary Schedule of Prior Audit Findings

Prepared by
Department of Finance

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Reference Number:	**2000-12-1**
Federal Catalog Number:	All Programs
State Administering Department:	Department of Finance
Fiscal Year Finding Initially Reported:	1995-96
Audit Finding:	Reporting Requirements. Because of limitations in its automated accounting systems, the State has not complied with the provision of OMB Circular A-133 requiring a schedule showing total expenditures for each federal program.
Status of Corrective Action:	Uncorrected. The State's accounting system will require substantial modification to meet all federal and state requirements. The State will address changes in relation to other priorities and costs.[1]

Reference Number:	**2000-3-7**
Federal Catalog Number:	10.558
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Cash Management. The Department of Education does not have adequate procedures for recovering cash advances in a timely manner from food program participants who are no longer entitled to these funds.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-5-3**
Federal Catalog Number:	10.558
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1996-97
Audit Finding:	Eligibility. The Department of Education needs to improve its process for ensuring that certain institutions participating in the food program meet the applicable licensing or approval requirements.
Status of Corrective Action:	Fully corrected.

Endnotes begin on page 167.

Reference Number:	**2000-7-2**
Federal Catalog Number:	10.555
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Matching, Reporting. The Department of Education lacked adequate controls and documentation to support its reported state match.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-14-5**
Federal Catalog Number:	10.550
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Special Tests and Provisions. The Department of Education (CDE) did not properly account for its donated foods.
Status of Corrective Action:	Partially corrected. Anticipated correction date is December 31, 2001. CDE continues to closely monitor the monthly inventory reconciliation process at the Sacramento warehouse.

Reference Number:	**2000-3-5**
Federal Catalog Number:	10.557, 93.268
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Cash Management. The Department of Health Services did not minimize the time between the receipt and disbursement of federal program funds for two programs reviewed.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-13-1**
Federal Catalog Number:	10.557, 93.917, 93.994
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Subrecipient Monitoring. The Department of Health Services (DHS) lacks an adequate system to ensure it promptly receives all audit reports from nonprofit subrecipients required to submit one and issues management decisions on reported findings.
Status of Corrective Action:	a. HIV Care Formula Grants: Fully corrected. b. Maternal and Child Health Services Block Grant: Partially corrected. DHS is implementing a system to identify and track non-profit subrecipients who are subject to OMB Circular A-133 audits. This system involves the development of a protocol for promptly issuing management decisions on audit findings. This protocol has been developed by the California Women, Infants, and Children (WIC) Branch, in conjunction with other DHS programs. Moreover, this protocol is based upon expert advice from the DHS Audits and Investigations (A&I) Division, as well as the WIC Branch and other Primary Care and Family Health programs. In the majority of cases, the Maternal and Child Health Branch issues the management decision. In those cases where a subrecipient is out of compliance with OMB Circular A-133, A&I has agreed to provide fiscal technical assistance to the subrecipient and to issue the management decision when the issue is resolved. In addition, this system includes revising current contract language. The language will be revised to state that a separate letter must be attached to the audit for those contractors that submit an audit other than an OMB A-133 audit. This letter must be signed and certified by the contractor stating that, under penalty of perjury, the contractor has not expended $300,000 or more in federal funds for the year in question. Affected DHS programs have agreed to meet on a quarterly basis until this system is fully operational.[2]

Reference Number:	**2000-13-2**
Federal Catalog Number:	10.550, 10.553, 10.555, 10.556, 10.558, 10.559, 84.002, 93.575, and 93.596
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1996-97
Audit Finding:	Subrecipient Monitoring. The Department of Education did not sufficiently monitor the audit reports of its nonprofit subrecipients.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-2-2**
Federal Catalog Number:	17.207, 17.225, 17.250, 17.801, 17.804, 17.253, and 84.278
State Administering Department:	Employment Development Department
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Allowable Costs and Cost Principles. The Employment Development Department lacked documentation supporting some of its payroll and operating costs allocated to federal programs.
Status of Corrective Action:	Fully corrected.[3]

Reference Number:	**2000-9-4**
Federal Catalog Number:	83.544, 83.548
State Administering Department:	Office of Emergency Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Suspension and Debarment. The Office of Emergency Services (OES) did not require Public Assistance Grants and Hazard Mitigation Grant program applicants to submit suspension and debarment certifications.
Status of Corrective Action:	Finding remains uncorrected. The OES disagrees with this finding. The Bureau of State Audits (BSA) reports that it "…contacted the Federal Emergency Management Agency (FEMA) legal staff for an interpretation of how this regulation applies. The FEMA legal staff indicated that suspension and disbarment requirements do not apply to the initial response to a disaster, but would apply to the later recovery operations." OES maintains that this undocumented opinion is inconsistent with 44 Code of Federal Regulations (CFR) 17.110(a) (2) (v), which clearly

intends to encompass both the initial response period and recovery period, in that it references both emergencies and disasters. Furthermore, 44 CFR 17.110(a)(2)(v) offers no guidance concerning when "initial response" activities end, and "later recovery transactions" begin. OES also notes that FEMA program staff continues to maintain that FEMA grants are exempt under this regulation, and they do not require OES, as grantee, to take any special actions with regards to suspended and debarred contractors. Therefore, OES does not agree with the BSA interpretation and does not expect to change its grant requirements until FEMA changes the regulations, or issues a nationally recognized policy establishing the demarcation between "initial response" and "later recovery transactions." OES further advises the BSA that the Public Assistance and Hazard Mitigation programs recently underwent a management audit by the FEMA Inspector General, and there was no mention of any deficiency in this area.[4]

Reference Number:	**2000-12-4**
Federal Catalog Number:	85.544, 83.548
State Administering Department:	Office of Emergency Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Reporting. The Office of Emergency Services' (OES) financial status reports contain unsupported expenditure information. As a result, FEMA cannot rely on these reports to accurately assess program status.
Status of Corrective Action:	Finding remains uncorrected. OES continues to experience staffing shortages as well as limited functions with the accounting system OES is mandated to utilize for our daily transactions. Further, due to the age of many of the federal grants (6 to 12 years), many records are not available or incomplete for all parties including the recipients. Therefore, we continue to negotiate with FEMA on an on-going basis regarding the appropriate reporting of grant expenditures, administrative allowances and other pertinent information.[5]

Reference Number:	**2000-12-5**
Federal Catalog Number:	83.544 and 83.548
State Administering Department:	Office of Emergency Services
Fiscal Year Finding Initially Reported:	1997-98
Audit Finding:	Reporting. In fiscal year 1999-00, the Office of Emergency Services (OES) did not reconcile the receipts

	and disbursements reported in its federal cash transaction reports to its official accounting records.
Status of Corrective Action:	Finding remains uncorrected. OES has not been successful in obtaining approval for additional staff that would be necessary to develop procedures and perform the more detailed reconciliation in addition to many other functions. OES does perform a general monthly reconciliation for receipts and disbursements that encompasses all accounting transactions for the Federal Trust Fund. It is OES's intention to make another attempt to request additional positions in the next Budget Year. [6]

Reference Number:	**2000-13-7**
Federal Catalog Number:	83.544 and 83.548
State Administering Department:	Office of Emergency Services
Fiscal Year Finding Initially Reported:	1996-97
Audit Finding:	Subrecipient Monitoring. The Office of Emergency Services does not ensure that a management decision regarding the resolution of audit findings is made within six months after it receives an audit report.
Status of Corrective Action:	Fully corrected.[7]

Reference Number:	**2000-1-1**
Federal Catalog Number:	84.181
State Administering Department:	Department of Developmental Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Activities Allowed. The Department of Developmental Services has not developed and implemented sufficient procedures to ensure that it disburses Early Intervention funds for allowable purposes.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-1-2**
Federal Catalog Number:	84.181
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Activities Allowed. The Department of Education (CDE) did not ensure that it disbursed Early Intervention program funds for allowable purposes, when it paid several subrecipients 75 percent of their individual grant awards without receiving and approving their applications.
Status of Corrective Action:	Partially corrected. Anticipated correction date is December 31, 2001. To ensure that program applications are approved prior to disbursement of program funds, CDE has transferred responsibility for the Early Intervention program to the Administrative Services Unit within the Special Education Division. CDE will not disburse 2001-02 program funds without the proper review and approval of applications.

Reference Number:	**2000-1-3**
Federal Catalog Number:	84.027 and 84.173
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Activities Allowed. The Department of Education did not ensure that it disbursed Special Education—Grants to States and Special Education—Preschool Grants program funds for allowable purposes.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-2-3**
Federal Catalog Number:	84.011
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Allowable Costs and Cost Principles. The Department of Education approved the use of $66,000 in Migrant Education funds without determining whether they are reasonable as required by OMB Circular A-87.
Status of Corrective Action:	Fully corrected.[8]

Reference Number:	**2000-2-4**
Federal Catalog Number:	84.011
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Allowable Costs and Cost Principles. The Department of Education (CDE) approved the use of $37,900 in Migrant Education funds during fiscal year 1999-00 that may not be an efficient use of resources as required by OMB Circular A-87.
Status of Corrective Action:	Finding remains uncorrected. CDE continues to seek approval of its sole source contract with Tromik Technology Corporation for technical services relating to the reporting of migrant pupil data and a Feasibility Study Report for the Migrant Education Program Student Information System.[9]

Reference Number:	**2000-3-1**
Federal Catalog Number:	84.048
State Administering Department:	California Community Colleges, Chancellor's Office
Fiscal Year Finding Initially Reported:	1997-98
Audit Finding:	Cash Management, Subrecipient Monitoring. The California Community Colleges, Chancellor's Office lacks adequate procedures to ensure subrecipients of the Vocational Education program minimize the time elapsing between the receipt and use of federal program funds. Additionally, it does not sufficiently monitor these subrecipients' use of the funds.
Status of Corrective Action:	Fully corrected.[10]

Reference Number:	**2000-3-2**
Federal Catalog Number:	84.243
State Administering Department:	California Community Colleges, Chancellor's Office
Fiscal Year Finding Initially Reported:	1997-98
Audit Finding:	Cash Management. The California Community Colleges, Chancellor's Office lacks adequate procedures to ensure subrecipients of the Tech-Prep program minimize the time elapsing between the receipt and use of federal program funds.
Status of Corrective Action:	Fully corrected.[10]

Reference Number:	**2000-3-3**
Federal Catalog Number:	84.186
State Administering Department:	Department of Alcohol and Drug Programs
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Cash Management, Subrecipient Monitoring. The Department of Alcohol and Drug Programs (DADP) lacks adequate procedures to ensure subrecipients of the Safe and Drug-Free Schools and Communities—State Grants program minimize the time elapsing between receipt and use of program funds. In addition, it does not sufficiently monitor the subrecipients' use of the funds.
Status of Corrective Action:	a. Cash Management: Partially corrected. Anticipated correction date is July 1, 2002. Counties are required to submit Quarterly Federal Financial Management Reports (QFFMR). A series of up to three letters may be sent if a county does not submit its QFFMR. Payments to counties have not been adjusted to reflect actual expenditure patterns. Adjustments to county payments will be made no later than the first payment commencing after July 1, 2002, as this is the first year of major changes to our allocation, contracting and payment system as well as revised quarterly reporting procedures.[11] b. Subrecipient Monitoring: Uncorrected. The DADP disagrees with this portion of the finding. DADP will resolve the matter with the U.S. Department of Education (DOE). The audit finding cites the DADP for not performing site visits to monitor the counties. While the DADP agrees that it is required to monitor subgrantees, per Public Law 104-156, there are other monitoring options in lieu of site visits. Such options include limited scope audits, or other means. In resolving the issue with the DOE, the DADP would like to discuss these options as well as the frequency and scope of any site visits that the DOE may require.

Reference Number:	**2000-3-4**
Federal Catalog Number:	84.011
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Cash Management and Subrecipient Monitoring. The Department of Education (CDE) lacks adequate procedures to ensure that Migrant Education program subrecipients minimize the time elapsing between the

receipt and use of federal program funds. Additionally, it does not sufficiently monitor these subrecipients' use of the funds.

Status of Corrective Action: Partially corrected. Anticipated correction date is October 31, 2002. CDE expects to complete its review of its Migrant Education allocation procedures by June 30, 2002, for implementation in fiscal year 2002-03. CDE will begin its monitoring reviews of Migrant Education regions in October 2002. [12]

Reference Number: **2000-5-1**

Federal Catalog Number: 84.126

State Administering Department: Department of Rehabilitation

Fiscal Year Finding Initially Reported: 1996-97

Audit Finding: Eligibility. The Department of Rehabilitation (Rehabilitation) does not always determine applicant eligibility within the required time period and did not document how it determined eligibility for one of the applicants the Bureau of State Audits reviewed.

Status of Corrective Action: Partially corrected. Anticipated correction date is July 2002. Rehabilitation generally agrees with this finding. Rehabilitation is considering the Bureau's recommendation as part of its continuing efforts to streamline and improve the vocational rehabilitation process. The redesign and improvement of the vocational rehabilitation process is significant and complex. A major goal in the redesign and improvement of the vocational rehabilitation process is to provide counselors with more time to work closely with their consumers to provide quality vocational rehabilitation, and, consequently, be enabled to make more effective and timely decisions in the determination of eligibility.

Rehabilitation will be holding a statewide District Administrators' meeting in November 2001 and will be discussing this finding. Rehabilitation is committed to identify "best practices" in the determination of eligibility for consumers. Through preliminary analysis of the causes for the finding, Rehabilitation has identified districts that are managing the eligibility determination process most effectively. Those districts' management practices will be shared with all of the districts.

In addition, based upon recommendations received from our Continuous Improvement Workgroup, Rehabilitation will provide counselors with focused training on eligibility determination. Rehabilitation will change its emphasis on eligibility determination as a compliance issue, and focus on eligibility determination as a customer service issue.

	Rehabilitation anticipates the training effort can be completed by July 2002.[13]
Reference Number:	**2000-8-1**
Federal Catalog Number:	84.181
State Administering Department:	Department of Developmental Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Period of Availability. The Department of Developmental Services inappropriately charged costs against an Early Intervention award for obligations that occurred before the award was available for expenditure.
Status of Corrective Action:	Fully corrected.
Reference Number:	**2000-9-1**
Federal Catalog Number:	84.181
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Suspension and Debarment. The Department of Education did not always have signed suspension and debarment certifications for participants of the Early Intervention program.
Status of Corrective Action:	Fully corrected.
Reference Number:	**2000-9-2**
Federal Catalog Number:	84.243
State Administering Department:	California Community Colleges, Chancellor's Office.
Fiscal Year Finding Initially Reported:	1997-98
Audit Finding:	Suspension and Debarment. The California Community Colleges, Chancellor's Office did not receive the required suspension and debarment certifications from all participants in the Tech-Prep program.
Status of Corrective Action:	Fully corrected.
Reference Number:	**2000-12-2**
Federal Catalog Number:	84.278

State Administering Department:	Employment Development Department
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Reporting. The Employment Development Department's (EDD) June 30, 2000, quarterly financial status report submitted to the U.S. Department of Education was incomplete.
Status of Corrective Action:	Partially corrected. The EDD School-to-Career (STC) Office has implemented a system to improve reporting performance. Advance notification to the subgrantees combined with an automated tracking system has improved reporting performance, but has not totally eliminated late subgrantee expenditure reporting. However, aggressive follow-up on late reports has improved the submission rate and accuracy of reported financial expenditures. The STC has emphasized to all subgrantees the importance of submitting quarterly reports by the established deadline and stressed the consequences of late and inaccurate reporting. The improved coordination between the STC office and the Fiscal Programs Division continues to improve the timeliness and completeness of expenditure data reported to the U.S. Department of Education. Significant progress has been achieved and continued emphasis will alleviate the problem of understated program expenditures.
Reference Number:	**2000-12-3**
Federal Catalog Number:	84.186
State Administering Department:	Department of Alcohol and Drug Programs
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Period Availability, Reporting. The Department of Alcohol and Drug Programs spent $2,562,167 of Safe and Drug-Free Schools and Communities State Grants program funds after the periods of availability for three of its grants ended. Additionally, it does not have adequate controls to ensure that its requests for federal funds agree with the grant expenditures for the program.
Status of Corrective Action:	Fully corrected.[14]
Reference Number:	**2000-13-3**
Federal Catalog Number:	84.340
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1999-00

Audit Finding:	Subrecipient Monitoring. The Department of Education does not adequately monitor either its subrecipients' use of Class Size Reduction program funds or their activities.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-13-4**
Federal Catalog Number:	84.027 and 84.173
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Subrecipient Monitoring. The Department of Education has not fully implemented a subrecipient monitoring system necessary to ensure that subrecipients of the Special Education—Grants to States program and Special Education—Preschool Grants program use federal grant money only for authorized purposes and take appropriate and timely corrective action on any deficiencies found.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-13-5**
Federal Catalog Number:	84.048, 84.243
State Administering Department:	California Community Colleges, Chancellor's Office
Fiscal Year Finding Initially Reported:	1995-96
Audit Finding:	Subrecipient Monitoring. The California Community Colleges Chancellor's Office (Chancellor's Office) did not sufficiently monitor and follow up on the reported audit findings of the State's 71 community college districts for fiscal year 1998-99.
Status of Corrective Action:	Partially corrected. Anticipated correction date is October 31, 2001. The Chancellor's Office process calls for a more timely review of the audit citings. We are currently in the process of issuing management decisions to the community college districts.

Reference Number:	**2000-14-1**
Federal Catalog Number:	84.126
State Administering Department:	Department of Rehabilitation
Fiscal Year Finding Initially Reported:	1999-00

Audit Finding:	Special Tests and Provisions. The Department of Rehabilitation (Rehabilitation) did not always ensure that a maximum effort was made by the individual to secure grant assistance from other sources before training and training services were paid for with grant funds.
Status of Corrective Action:	Partially corrected. Anticipated correction date is July 2002. The Comparable Benefits Workgroup was established in February 2001, and has been working to establish and implement a directive for all employees that clearly defines the policy and procedures necessary to ensure Rehabilitation's maximum efforts. The draft of the directive will be routed for review in October 2001. The workgroup has also been working closely with the Collaborative Services Section to establish interagency agreements with the various education and financial aid agencies to ensure the consistent application of the regulations regarding vocational rehabilitation and financial aid opportunities for persons with disabilities. As part of this effort, the Comparable Benefits Workgroup will be recommending that counselors participate along with financial aid administrators in annual training that is provided by the Student Aid Commission (SAC). This training will provide information to the counselors regarding the requirements for applying for financial aid so that this information can be shared with consumers applying for grants and other financial aid. The workgroup has also explored strategies to ensure documentation of the maximum efforts in the consumer's case file. The workgroup will be making a recommendation in this area as well. The workgroup will soon be presenting all of their final recommendations for management review and approval. Regarding the one consumer who appeared to have received duplicate payment for education expenses, Rehabilitation later determined that the grant had been used for the consumer's living expenses in lieu of Rehabilitation providing maintenance expenses for this consumer. There was no duplicate payment to this consumer. The university received only one tuition payment and that was from Rehabilitation.
Reference Number:	**2000-14-2**
Federal Catalog Number:	84.010, 84.011
State Administering Department:	Department of Education
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Subrecipient Monitoring, Special Tests and Provisions. The Department of Education (CDE) did not sufficiently

monitor Local Educational Agencies to ensure they complied with the comparability requirement.

Status of Corrective Action: Finding remains uncorrected. CDE continues to work with the U.S. Department of Education to develop an effective monitoring process for the Title I and Migrant Education comparability requirement, which can be implemented using existing program resources. CDE expects to have a process in place by December 31, 2001.[15]

Reference Number: **2000-14-3**

Federal Catalog Number: 84.032

State Administering Department: California Student Aid Commission

Fiscal Year Finding Initially Reported: 1996-97

Audit Finding: Special Tests and Provisions. The California Student Aid Commission's (CSAC) auxiliary organization administers the loan program. The information the auxiliary organization reports to the federal government for computing the reinsurance rate is not always accurate; thus, the auxiliary organization may not be receiving the correct amount of funds.

Status of Corrective Action: Partially corrected. CSAC has an ongoing process to ensure loan and enrollment statuses are in agreement with all participating parties. CSAC and its auxiliary EDFUND recognize how important it is that CSAC/EDFUND loan records match the loan records of partnering lenders and schools. Over the last several years, major efforts have been undertaken and great strides have been made to insure that these separate databases are consistent and to minimize the instances where loan and enrollment statuses even could be inconsistent. It has been pointed out in prior responses to this issue that CSAC/EDFUND does not have control of the activities of schools, lenders, and the National Student Loan Data System (NSLDS) and their corresponding databases. This inherent lack of control means that some inconsistencies may (and in fact will) occur.

CSAC/EDFUND have continued to monitor the accuracy of the enrollment status by comparing the NSLDS enrollment data with its own records. Borrower records, if warranted, are corrected as a result of this status checking. Since the most recent single state audit was completed an additional process has been instituted whereby the total loan database is sampled and borrower statuses are verified against the NSLDS database. This process is now being performed regularly in order to identify and communicate with schools that do not promptly report status changes.

Reference Number:	**2000-13-6**
Federal Catalog Number:	84.181 and 93.778
State Administering Department:	Department of Developmental Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Subrecipient Monitoring. The Department of Developmental Services (DDS) does not fulfill all of its subrecipient monitoring responsibilities.
Status of Corrective Action:	Partially corrected. Anticipated Correction date is November 2001. During February 2000, the Bureau of State Audits (BSA) found that the DDS failed to provide subrecipients with information necessary to identify the federal sources of funds provided to them under the above-named grant. During March of 2001, DDS informed recipients of Early Intervention funds about the grant award numbers and names in order to correct the BSA's finding. The recipients include some regional centers as well as other organizations. They are informed about federal award names and numbers in an annual announcement. The subrecipients are informed during the process of completing an annual application for funding and the federal award number is contained on the final award contract. DDS is also implementing procedures for informing all 21 regional centers of the federal award information for federal funding received from DDS. These procedures are expected to be in place by November 30, 2001.

Reference Number:	**2000-2-1**
Federal Catalog Number:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Allowable Costs and Cost Principles. The Department of Health Services (DHS) does not adequately use its automated claim payment system to prevent or minimize the overpayment of certain provider claims and did not adequately document denials of other health coverage.
Status of Corrective Action:	a. Maximum Quantity of Prescription Drugs: Partially corrected. The Single Audit recommends DHS "enter in its system maximum 100-day supply for each prescription drug item." To accomplish this, DHS will need to change the "maximum quantity" data element for each drug listing in the Formulary File.

DHS recognized this issue prior to the Single Audit. Historically, DHS has issued instructions to Electronic Data Systems (EDS), the Medi-Cal fiscal intermediary, to change the maximum quantities of various drugs on a case-by-case basis. Because the case-by-case review and implementation of maximum quantities is a slow, laborious process for which neither DHS nor EDS have adequate pharmacist staffing, an alternative approach was necessary. Due to the need to be more efficient in altering maximum quantities, (the value used to establish the 100 day supply quantity limit) the DHS and EDS began a systematic approach to altering the maximum quantity. EDS proposed this systematic approach in Cost Containment Proposal (CCP) #98-008. Subsequently, DHS issued Operational Instruction Letter #333-99, December 14, 1999, directing EDS to implement the maximum quantity strategies outlined in CCP #98-008. Additionally, DHS and EDS are currently reviewing the maximum quantity of injectable drug products which tend to be a large percentage of the billing errors reviewed. This review will most likely result in a decrease in the maximum quantity allowed for various injectable drugs.

In addition to this systematic approach, DHS continues to review erroneous billed amounts through the drug rebate dispute resolution process. When it identifies an erroneous billing amount, DHS reviews the maximum quantity of the drug and implements changes as necessary to prevent future errors. The Rebate Accounting and Information System (RAIS) which is scheduled to be implemented January 1, 2002, will aid in this review. DHS is designing RAIS reports to help identify erroneous billing quantities as a tool in establishing future quantity edits. Based on these efforts, DHS believes it is complying with the BSA's recommendation; DHS' current efforts to revise maximum quantities will prevent a significant number of erroneous claims from being processed, therefore reducing overpayment of provider drug claims.

b. Overpayment of Long Term Care Claims: Fully corrected.

c. Retention of Medicare Denials: Fully corrected.

Reference Number:	**2000-3-6**
Federal Catalog Number:	93.767
State Administering Department:	Managed Risk Medical Insurance Board
Fiscal Year Finding Initially Reported:	1999-00

Audit Finding:	Cash Management. The Managed Risk Medical Insurance Board did not adequately minimize the amount of time elapsing between the transfer of federal funds to the State and their disbursement for program costs.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-5-2**
Federal Catalog Number:	93.767
State Administering Department:	Managed Risk Medical Insurance Board
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Eligibility. The Managed Risk Medical Insurance Board does not always ensure it enrolls into the program only eligible individuals.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-7-1**
Federal Catalog Number:	93.994
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Earmarking. The Department of Health Services does not have adequate procedures to ensure that it meets the program's earmarking requirements.
Status of Corrective Action:	Fully corrected.[16]

Reference Number:	**2000-9-3**
Federal Catalog Number:	93.268, 93.917, and 93.994
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Suspension and Debarment. The Department of Health Services did not always require participants to submit signed suspension and debarment certifications.
Status of Corrective Action:	Fully corrected.[17]

Reference Number:	**2000-10-1**
Federal Catalog Number:	93.767

State Administering Department:	Managed Risk Medical Insurance Board
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Program Income. The Managed Risk Medical Insurance Board does not prepare an adequate reconciliation to ensure that it receives all program income it has earned.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-12-6**
Federal Catalog Number:	93.994
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Reporting. The Department of Health Services does not always report complete information in its annual program report to the U.S. Department of Health and Human Services.
Status of Corrective Action:	Fully corrected.[18]

Reference Number:	**2000-12-7**
Federal Catalog Number:	93.674
State Administering Department:	Department of Social Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	Reporting. The Department of Social Services still does not ensure that counties expending Independent Living Program funds include all the required information on their performance reports.
Status of Corrective Action:	Fully corrected.

Reference Number:	**2000-14-4**
Federal Catalog Number:	93.268
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1999-00
Audit Finding:	Special Tests and Provisions. The Department of Health Services did not properly account for its vaccine inventory when it reported incomplete inventory information to the

	Centers for Disease Control and Prevention (federal agency).
Status of Corrective Action:	Fully corrected.
Reference Number:	**2000-14-6**
Federal Catalog Number:	93.778
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1997-98
Audit Finding:	Special Tests and Provisions. The Department of Health Services does not have adequate controls over provider agreements and disclosures.
Status of Corrective Action:	Fully corrected.[19]

ENDNOTES—AUDITOR COMMENTS

[1] The status of this issue remains unchanged. Please refer to reference number **2001-12-7** for additional information.

[2] We reported a similar weakness during our audit for fiscal year 2000-01. Please refer to reference number **2001-13-1** for additional information.

[3] We reviewed the status of this issue during our audit of fiscal year 2000-01 and found that the Employment Development Department had not yet fully developed documentation for all allocation codes. Therefore, we reported a similar weakness for these programs. Please refer to reference number **2001-2-1** for additional information.

[4] We reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-9-5** for additional information.

[5] We reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-12-4** for additional information.

[6] We reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-12-5** for additional information.

[7] We reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-13-3** for additional information.

[8] We reviewed the status of this issue during our audit of fiscal year 2000-01 and found that Education continued to use Migrant Education funds without always determining whether costs are reasonable as required by OMB Circular A-87. Therefore, we reported a similar weakness for this program. Please refer to reference number **2001-2-3** for additional information.

[9] We reported a similar weakness during our audit of fiscal year 2000-01. Please refer to reference number **2001-2-3** for additional information.

[10] We reviewed the status of this issue during our audit of fiscal year 2000-01 and found that the Chancellor's Office had not yet fully implemented adequate procedures to ensure that subrecipients minimize the time elapsing between their receipt and use of federal program funds. Therefore, we reported a similar weakness for this program. Please refer to **2001-3-8** for additional information.

[11] We reviewed the status of this issue during our audit of fiscal year 2000-01 and found that Alcohol and Drug Programs did not ensure that subrecipients minimized the time elapsing between their receipt and use of federal program funds. Therefore, we reported a similar weakness for this program. Please refer to reference number **2001-3-7** for additional information.

[12] We reported a similar weakness during our audit of fiscal year 2000-01. Please refer to reference number **2001-3-3** for additional information.

[13] We reported a similar weakness during our audit of fiscal year 2000-01. Please refer to reference number **2001-5-2** for additional information.

[14] We reviewed the status of this issue during our audit of fiscal year 2000-01 and found that Alcohol and Drug Programs did not always ensure that charges to federal awards are within each award's period of availability. Therefore, we reported a similar weakness for fiscal year 2000-01. Please refer to reference number **2001-8-2** for additional information.

[15] We reported a similar weakness during our audit of fiscal year 2000-01. Please refer to **2001-14-3** for additional information.

[16] Our testing for fiscal year 2000-01 revealed a similar weakness; namely, the department did not obtain sufficient information from subrecipients related to the earmarking requirements. Please refer to reference number **2001-7-1** for additional information.

[17] Although Health Services modified its standard contract for fiscal year 2001-02 to include the suspension and debarment certification, it has not implemented procedures to obtain these certifications from its subrecipients for fiscal year 2000-01. Therefore, we reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-9-2** for additional information.

[18] Although the Health Services added new footnotes to its annual report explaining that some of the amounts are based on estimates, it continues to not disclose that other amounts are based on estimates. Therefore, we reported a similar weakness in our audit of fiscal year 2000-01. Please refer to reference number **2001-12-1** for additional information.

[19] Health Services has completed only part of its effort to re-enroll the 140,000 providers of Medicaid services. Therefore, we reported a similar weakness for this program. Please refer to reference number **2001-14-4** for additional information.

Agency's response provided as text only:

Department of Finance
Office of the Director
State Capitol, Room 1145
Sacramento, CA 95814-4998

March 12, 2002

Ms. Elaine M. Howle
State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

State of California: Internal Control and State and Federal Compliance Audit Report For the Year Ended June 30, 2001

Thank you for the opportunity to respond to the internal control and state and federal compliance audit report. This report was the result of your examination of the State's general purpose financial statements for the fiscal year ended June 30, 2001, and will be part of the Single Audit Report covering this period. We accept the reported findings and recommendations. Although our internal controls and administration of federal awards can always be improved, the conclusion that none of the findings were material weaknesses is evidence of the State's effective fiscal oversight.

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

In meeting our responsibility for financial leadership and oversight, the Department of Finance conducts internal control reviews of State departments and also reviews areas of potential weakness in the State's fiscal systems. In addition, we provide oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further, we have an ongoing process of issuing Audit Memos to departments that establish statewide policy and provide technical advice on various audit related issues. We will soon issue an Audit Memo concerning the results of the fiscal year 2000-01 Single Audit.

The head of each State department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed and is modified for changing conditions.

Moreover, all levels of State management must be involved in assessing and strengthening their system of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds.

Individual departments have separately responded to the report's findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

The Department of Finance will continue to provide leadership to ensure the proper financial operations and business practices of the State, and to ensure that internal controls exist for the safeguarding and effective use of assets and resources.

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

Sincerely,

(Signed by B. Timothy Gage)

B. TIMOTHY GAGE
Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press

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