Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California

Financial Statements for the Years Ended June 30, 2008 and 2007, and Independent Auditors' Report

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	2–4
FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2008 AND 2007:	
Balance Sheets	5
Statements of Revenues, Expenses, and Changes in Fund Equity	6
Statements of Cash Flows	7
Notes to Financial Statements	8–10

Deloitte & Touche LLP
Suite 400
2868 Prospect Park Drive
Rancho Cordova, CA 95670-6065
USA

Tel: +1 916 288 3100
Fax: +1 916 288 3131
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Debenture Revenue Fund (the "Fund"), Department of Veterans Affairs of the State of California (the "Department") as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in fund equity, and of cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the Fund and are not intended to present the financial position of the Department of Veterans Affairs of the State of California or the results of its operations and cash flows of its proprietary funds.

Management's Discussion and Analysis on pages 2 through 4, is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The supplementary information is the responsibility of the Department's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we do not express an opinion on it.

Deloitte & Touche LLP

October 31, 2008

VETERANS DEBENTURE REVENUE FUND, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

Introduction & Overview – Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California

This discussion and analysis presents the highlights of financial activities and financial position for the Veterans Debenture Revenue Fund (the "Fund"), Department of Veterans Affairs, State of California (the "Department"). The analysis is designed to provide readers with information that the Fund's management believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. It is intended to help readers see the Fund through the eyes of management. It is further designed to provide context for the financial statements and information about the Fund's operations and cash flows.

Management's Discussion and Analysis ("MD&A") is based on currently known facts, decisions, and conditions that existed as of the date of the independent auditors report.

The Fund was established for the maintenance of a Bond Reserve Account as required by the revenue bond resolution of the Department. The resolution requires a reserve in an amount not less than three percent of the aggregate outstanding principal of all Revenue Bonds with interest rates fixed to maturity held by the Department.

Fiscal Year 2008 Compared to Fiscal Year 2007

Condensed Balance Sheets

The following table presents condensed balance sheets for the Fund as of June 30, 2008 and June 30, 2007, (dollars in thousands) and the change from year to year:

	2008	2007	Change	% Change
ASSETS				
Current Assets:				
Cash and cash equivalents	$ 7,396	$ 7,396	$ -	0.0 %
Other assets	174	154	20	13.0 %
Total current assets	7,570	7,550	20	
Noncurrent assets—Investments	24,562	24,562	-	0.0 %
TOTAL ASSETS	$ 32,132	$ 32,112	$ 20	
LIABILITIES & FUND EQUITY				
Current liabilities—Bond reserve due to the	$ 175	$ 155	$ 20	100.0 %
Noncurrent liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	31,957	31,957	-	0.0 %
Fund equity	-	-	-	0.0 %
TOTAL LIABILITIES AND FUND EQUITY	$ 32,132	$ 32,112	$ 20	

Assets, Liabilities and Fund Equity

Total assets, liabilities and fund equity increased a minimal amount due to an increase in other assets as of June 30, 2008 and June 30, 2007.

Condensed Statements of Revenues and Expenses

The following table presents the statements of revenues and expenses for the Fund for the years ended June 30, 2008 and 2007, (dollars in thousands) and the change from year to year:

	2008	2007	Change	% Change
REVENUES—Income from investments	$ 1,683	$ 1,713	$ (30)	(1.8)%
EXPENSES—Transfers out to Veterans Farm and Home Building Fund of 1943	1,683	1,713	(30)	(1.8)%
OPERATING INCOME	-	-	-	0.0 %
FUND EQUITY—Beginning of year	-	-	-	0.0 %
FUND EQUITY—End of year	$ -	$ -	$ -	0.0 %

Revenues & Expenses

All income generated by the Fund represents amounts due to the Farm and Home Fund and accordingly has been reflected as operating transfers out in the statements of revenues, expenses and changes in fund equity.

Fiscal Year 2007 Compared to Fiscal Year 2006

Condensed Balance Sheets

The following table presents condensed balance sheets for the Fund as of June 30, 2007 and June 30, 2006, (dollars in thousands) and the change from year to year:

	2007	2006	Change	% Change
ASSETS				
Current Assets:				
Cash and cash equivalents	$ 7,396	$ 12,517	$ (5,121)	(41)%
Other assets	154	489	(335)	(69)%
Total current assets	7,550	13,006	(5,456)	
Noncurrent assets—Investments	24,562	24,562	-	0 %
TOTAL ASSETS	$ 32,112	$ 37,568	$ (5,456)	
LIABILITIES & FUND EQUITY				
Current liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	$ 155	$ -	$ 155	100 %
Noncurrent liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	31,957	37,568	(5,611)	(15)%
Fund equity	-	-	-	-
TOTAL LIABILITIES AND FUND EQUITY	$ 32,112	$ 37,568	$ (5,456)	

Assets, Liabilities and Fund Equity

Total assets, liabilities and fund equity decreased by $5.5 million from $37.6 million as of June 30, 2006 to $32.1 million as of June 30, 2007. This decrease consisted primarily of the following items:

- Total cash and cash equivalents decreased by $5.1 million from $12.5 million as of June 30, 2006 to $7.4 million as of June 30, 2007. The Fund transferred $6.8 million of cash and cash equivalents to the Veterans Farm and Home Building Fund of 1943 during fiscal year 2007. The Fund received $1.7 million in investment income during fiscal year 2007.

- Total receivables as of June 30, 2006 were $0.5 million, which decreased to zero as of June 30, 2007.

Condensed Statements of Revenues and Expenses

The following table presents the statements of revenues and expenses for the Fund for the years ended June 30, 2007 and 2006, (dollars in thousands) and the change from year to year:

	2007	2006	Change	% Change
REVENUES—Income from investments	$ 1,713	$ 2,022	$ (309)	(15.3)%
EXPENSES—Transfers out to Veterans Farm and Home Building Fund of 1943	1,713	2,022	(309)	(15.3)%
OPERATING INCOME	-	-	-	-
FUND EQUITY—Beginning of year	-	-	-	-
FUND EQUITY—End of year	$ -	$ -	$ -	-

Revenues & Expenses

All income generated by the Fund represents amounts due to the Farm and Home Fund and accordingly has been reflected as operating transfers out in the statements of revenues, expenses and changes in fund equity.

VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS
JUNE 30, 2008 AND 2007

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents:		
Cash in State Treasury	$ 650	$ 650
State of California's Surplus Money Investment Fund	7,395,000	7,395,000
Total cash and cash equivalents	7,395,650	7,395,650
Interest receivable—Investments	175,237	154,484
Total current assets	7,570,887	7,550,134
NONCURRENT ASSETS—Investment agreements (at cost)	24,561,500	24,561,500
TOTAL	$32,132,387	$32,111,634
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES—Due to the Veterans Farm and Home Building Fund of 1943	$ 175,237	$ 154,484
NONCURRENT LIABILITIES—Bond reserve due to the Veterans Farm and Home Building Fund of 1943	31,957,150	31,957,150
FUND EQUITY	-	-
TOTAL	$32,132,387	$32,111,634

See notes to financial statements.

VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
REVENUES—Income from investments	$ 1,683,398	$ 1,712,745
EXPENSES—Transfers out to Veterans Farm and Home Building Fund of 1943	1,683,398	1,712,745
OPERATING INCOME	-	-
FUND EQUITY—Beginning of year	-	-
FUND EQUITY—End of year	$ -	$ -

See notes to financial statements.

VETERANS DEBENTURE REVENUE FUND
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from investment income	$ 1,683,398	$ 1,712,745
Payments to other funds	(1,683,398)	(6,833,895)
Net cash used for operating activities	-	(5,121,150)
DECREASE IN CASH AND CASH EQUIVALENTS	-	(5,121,150)
CASH AND CASH EQUIVALENTS:		
Beginning of year	7,395,650	12,516,800
End of year	$ 7,395,650	$ 7,395,650
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Excess of revenues over expenses	$ -	$ -
Adjustments to reconcile to net cash used by operating activities—effect of changes in assets and liabilities:		
(Increase) decrease in interest receivable	(20,753)	(40,793)
Decrease (increase) in due from other funds	-	375,509
Increase in due to Veterans Farm & Home Building Fund of 1943	20,753	154,484
Decrease in noncurrent liabilities	-	(5,610,350)
NET CASH USED FOR OPERATING ACTIVITIES	$ -	$ (5,121,150)

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Fund—The California Department of Veterans Affairs (the "Department") is a separate legal entity, acting as a Cabinet level agency of the State of California. A seven-member California Veterans Board (the "Board") has policy oversight of the operations of the Department. The Board's membership consists of the seven members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Department is authorized to issue revenue bonds to fund low-interest farm and home loan contracts with veterans living in the state of California.

In December 1997, the Department amended the revenue bond resolution provision regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (the "Fund"). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount not less than three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B and C Bonds, 2001 Series A Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. With respect to the 2002 Series A Bonds, the Resolution requires an amount equal to at least five percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Veterans Farm and Home Building Fund of 1943 ("Farm and Home Fund"), at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Farm and Home Fund.

At June 30, 2008 and 2007, the liabilities of the Fund represent amounts due to the Farm and Home Fund and, accordingly, are included as a receivable in the financial statements of the Farm and Home Fund.

The financial statements represent only the activities of the Fund and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary funds. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting—The Fund is classified as a proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and become measurable, and expenses are recognized as incurred.

Cash and cash equivalents—The Fund considers all cash and highly liquid investments purchased with original maturities of three months or less to be cash equivalents. At June 30, 2008 and 2007, cash equivalents consisted of the State of California's Surplus Money Investment Fund, carried at cost, which approximates fair value at June 30, 2008 and 2007.

Investments—All investments are reported at fair value except for nonparticipating fixed interest investment agreements, which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers. Income from investments includes net unrealized appreciation or depreciation in the fair value of investments.

Revenues and Operating Transfers—Income from investments is recorded as earned. A corresponding operating transfer out is recorded to reflect the required transfer to the Farm and Home Fund.

2. CASH, CASH EQUIVALENTS AND INVESTMENTS

Cash in State Treasury—Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable. The carrying amount of the Fund's deposits in State Treasury was $650 as of June 30, 2008 and 2007.

State of California's Surplus Money Investment Fund ("***SMIF")***—Cash in the SMIF represents the value of the deposits in the State Treasurer's pooled investment program, which 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, 2008 and 2007, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value. The carrying amount of the Fund's deposits in SMIF was $7,395,000 as of June 30, 2008 and 2007.

Investments—Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments. These investments include direct obligations of the U.S. Government and its agencies and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service.

The Fund's investment agreements, carried at cost, was $24,561,500 as of June 30, 2008 and 2007. The interest rates on investment agreements are fixed and range from 5.38% to 5.75%. The investment agreements expire from 2015 to 2028.

Investment Risk Factors—Many factors can affect the value of investments. Some, such as credit risk, custodial credit risk, concentration of credit risk and interest rate risk, may affect both equity and fixed

income securities. Equity and debt securities respond to such factors as economic conditions, individual company earning performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds within SMIF and the remainder in investment contracts or with insurance administrators to limit the Fund's exposure to most types of investment risk.

Credit Risk—Fixed income securities are subject to credit risk, which is the chance that a issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. Government, are not considered to have credit risk. At June 30, 2008 and 2007, the Fund does not have any investments exposed to credit risk.

Custodial Credit Risk—Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At June 30, 2008 and 2007, the Fund did not have any investments exposed to custodial credit. All investments are held by the State of California.

Concentration of Credit Risk—Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At June 30, 2008 and 2007, the Fund does not have any investments exposed to concentration of credit risk.

Interest Rate Risk—Interest rate risk is the risk that the value of fixed income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At June 30, 2008 and 2007, the Fund does not have any debt investments that are highly sensitive to changes in interest rates.

The Fund's investments in the investment agreements are categorized as risk category 1, which is defined by Governmental Accounting Standards Board Statement No. 3 and No. 40 as investments that are insured, registered or for which the securities are held by the Fund or its agent in the Fund's name.

The Fund's investments at June 30, 2008 and 2007 are as follows:

	2008	**2007**
Category 1		
Investment agreements (at cost)	$24,561,500	$24,561,500

* * * * * *