



Report of Independent Auditors
and Financial Statements

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

June 30, 2013 and 2012

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

California Veterans Board
State of California

Report on Financial Statements

We have audited the accompanying financial statements of Veterans Debenture Revenue Fund (the "Fund"), Department of Veterans Affairs, State of California (the "Department"), which comprise the statement of net position as of June 30, 2013, and the related statements of revenues, expenses, and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Veterans Debenture Revenue Fund (the "Fund"), Department of Veterans Affairs, State of California (the "Department") as of June 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

The financial statements represent only the activities of the Fund and are not intended to present the financial position of the Department and the results of its operations and its 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.

Other Matters

Prior Year Audited Financial Statements

The financial statements of the Fund as of and for the year ended June 30, 2012 were audited by other auditors whose report dated October 18, 2012, expressed an unmodified opinion on those statements.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Sacramento, California
October 14, 2013

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL POSITION AND RESULTS OF OPERATIONS**

INTRODUCTION AND 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 Report of Independent Auditors.

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.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL POSITION AND RESULTS OF OPERATIONS (CONTINUED)**

FINANCIAL ANALYSIS

Condensed statements of net position

The following table presents condensed statements of net position for the Fund as of June 30, 2013, 2012, and 2011 (in thousands):

ASSETS

	<u>2013</u>	<u>2012</u>	<u>2011</u>
CURRENT ASSETS			
Cash and cash equivalents	\$ 15,742	\$ 10,009	\$ 4,191
Other assets	<u>10</u>	<u>37</u>	<u>72</u>
Total current assets	<u>15,752</u>	<u>10,046</u>	<u>4,263</u>
NONCURRENT ASSETS			
Investments	<u>-</u>	<u>5,733</u>	<u>15,551</u>
Total assets	<u>\$ 15,752</u>	<u>\$ 15,779</u>	<u>\$ 19,814</u>

LIABILITIES AND NET POSITION

CURRENT LIABILITIES			
Bond reserve due to the Veterans Farm and Home Fund of 1943	<u>\$ 10</u>	<u>\$ 37</u>	<u>\$ 72</u>
NONCURRENT LIABILITIES			
Bond reserve due to the Veterans Farm and Home Fund of 1943	15,742	15,742	19,742
Net Position	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities and net position	<u>\$ 15,752</u>	<u>\$ 15,779</u>	<u>\$ 19,814</u>

Assets, Liabilities and Net Position

Total assets and liabilities decreased marginally as of June 30, 2013 when compared to the balances as of June 30, 2012. Approximately \$5.7 million in assets shifted from non-current to current classification. This shift was the result of the redemption of certain investments classified as non-current that are now maintained as cash and cash equivalents.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL POSITION AND RESULTS OF OPERATIONS (CONTINUED)**

FINANCIAL ANALYSIS (CONTINUED)

The lack of a net position as of June 30, 2013 or June 30, 2012, is a function of the income or loss generated by the Fund being distributed to the Veterans Farm and Home Fund of 1943.

Total assets and liabilities decreased by approximately \$4 million as of June 30, 2012, when compared to the balances as of June 30, 2011. The reduction was due to lower bond reserve requirements due to the paydown of bonds outstanding. Additionally, there was a shift in assets from non-current to current classification. This shift was the result of the redemption of certain investments classified as non-current that were maintained as cash and cash equivalents at June 30, 2012.

Condensed Statements of Revenues, Expenses, and Changes in Net Position

The following table presents the statements of revenues, expenses, and changes in net position for the Fund for the years ended June 30, 2013, 2012, and 2011 (in thousands):

	<u>2013</u>	<u>2012</u>	<u>2011</u>
OPERATING REVENUES			
Income from investments	\$ 175	\$ 740	\$ 2,142
OPERATING EXPENSES	<u>-</u>	<u>-</u>	<u>-</u>
NET OPERATING INCOME	<u>175</u>	<u>740</u>	<u>2,142</u>
NONOPERATING REVENUE (EXPENSE)			
Transfers out to Veterans Farm and Home Building Fund of 1943	<u>(175)</u>	<u>(740)</u>	<u>(2,142)</u>
Deficiency of revenues over expenses	-	-	-
NET POSITION			
Balance, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>
Balance, end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Revenues and Expenses

All income generated by the Fund represents amounts due to the Farm and Home Fund and, accordingly, has been reflected as transfers out in the statements of revenues, expenses and changes in net position. The reduction in income and related expenses for each period presented was a function of a lower level of average investment balances outstanding. Although average cash balances have increased, the cash balances do not earn a comparable level of interest as the Fund's investments.

FINANCIAL STATEMENTS

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF NET POSITION**

ASSETS

	JUNE 30,	
	2013	2012
CURRENT ASSETS		
Cash and cash equivalents		
Cash in State Treasury	\$ 1,300	\$ 1,300
State of California SMIF	15,741,000	10,008,000
Total cash and cash equivalents	15,742,300	10,009,300
Interest receivable - investments	9,642	37,157
Total current assets	15,751,942	10,046,457
NONCURRENT ASSETS - Investment contracts, at cost	-	5,733,000
	<u>\$ 15,751,942</u>	<u>\$ 15,779,457</u>

LIABILITIES AND NET POSITION

CURRENT LIABILITIES		
Due to the Farm and Home Fund	\$ 9,642	\$ 37,157
NONCURRENT LIABILITIES		
Bond reserve due to the Farm and Home Fund	15,742,300	15,742,300
Total liabilities	15,751,942	15,779,457
NET POSITION	-	-
	<u>\$ 15,751,942</u>	<u>\$ 15,779,457</u>

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**

	YEARS ENDED JUNE 30,	
	2013	2012
OPERATING REVENUES		
Income from investments	\$ 175,102	\$ 739,572
OPERATING EXPENSES	-	-
NET OPERATING INCOME	175,102	739,572
NONOPERATING REVENUE (EXPENSE)		
Transfers out to Veterans Farm and Home Building Fund of 1943	(175,102)	(739,572)
Excess of revenues over expenses	-	-
NET POSITION		
Balance, beginning of year	-	-
Balance, end of year	\$ -	\$ -

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF CASH FLOWS**

	YEARS ENDED JUNE 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from investment income	\$ 202,617	\$ 774,709
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Payments to other funds	(202,617)	(4,774,709)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	5,733,000	9,817,850
NET CHANGE IN CASH AND CASH EQUIVALENTS	5,733,000	5,817,850
CASH AND CASH EQUIVALENTS		
Beginning of year	10,009,300	4,191,450
End of year	<u>\$ 15,742,300</u>	<u>\$ 10,009,300</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES		
Net operating income	\$ 175,102	\$ 739,572
Adjustments to reconcile net cash used in operating activities, effect of changes in assets and liabilities		
Decrease in interest receivable and investments in agreements	27,515	35,137
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ 202,617</u>	<u>\$ 774,709</u>

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Fund – Department of Veterans Affairs, State of California (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 3% of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. 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 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 Fund are transferred to the Farm and Home Fund.

At June 30, 2013 and 2012, 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 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.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2013 and 2012, cash equivalents consisted of the state of California Surplus Money Investment Fund (SMIF), carried at cost, which approximates fair value at June 30, 2013 and 2012.

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.

Revenue recognition, classification of operating revenues and expenses – Income is recognized when it is earned. Operating income includes income earned on invested funds. Operating expenses include direct expenses incurred in the administration of the Fund. Non-operating revenues and expense relate to transfers received and/or provided to other funds.

NOTE 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 \$1,300 as of June 30, 2013 and 2012.

State of California 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, 2013 and 2012, 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. For a complete description of the risks related to this program refer to the State of California Comprehensive Annual Financial Report that includes information about the state’s pooled investment program. The carrying amount of the Fund’s deposits in SMIF was \$15,741,000 as of June 30, 2013 and \$10,008,000 as of June 30, 2012.

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.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
NOTES TO FINANCIAL STATEMENTS**

NOTE 2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

Investments (continued) – The Fund’s investments include Guaranteed investment Contracts (GICs) with insurance companies. The GICs are collateralized by investments held by the State of California on behalf of the Fund. Additionally, the Fund only invests in investment agreements issued by highly rated insurance companies and management regularly monitors the credit rating of the insurance companies issuing such investment agreements as part of monitoring the Fund’s exposure to credit risk.

The Fund’s investment agreements, carried at cost, were \$5,733,000 as of June 30, 2012. The interest rates on investment agreements were fixed and ranged from 5.38% to 5.62%. The investment agreements expired from 2019 to 2028. The Fund redeemed all outstanding investment agreements as of June 30, 2013.

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 an 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, 2013 and 2012, the Fund does not have significant 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, 2013 and 2012, the Fund did not have any investments exposed to custodial credit risk. 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, 2013 and 2012, the Fund did not have a significant concentration of credit risk.

Interest rate risk – Interest rate risk is the risk that the value affixed-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, 2013 and 2012, the Fund does not have any significant debt investments that are highly sensitive to changes in interest rates.