Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs, State of California

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

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

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INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943 (the "Fund"), which is administered by the 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.

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

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California 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 11, the accompanying 2007 balance sheet have been restated.

Management's Discussion and Analysis on pages 2 through 8 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This 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 FARM AND HOME BUILDING FUND OF 1943

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

Introduction – The Department of Veterans Affairs

The Department of Veterans Affairs (the "Department") began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature of the Veterans Farm and Home Purchase Act of 1921 (the "Cal-Vet Farm and Home Program" or the "Program"). In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 which modified the Program to meet new needs of California's veterans. The 1943 Act established the 1943 Fund in the State Treasury and the Department established the Veterans Farm and Home Building Fund of 1943 (the "Fund"), which is the principal fund utilized for the Cal-Vet Farm and Home Loan Program. Financing is provided as installment loans, which are referred to as Contracts of Purchase.

The sales of the Fund's Home Purchase Revenue Bonds and Veterans General Obligations Bonds combined with monies received from prepayments of Contracts of Purchase and other revenues under the Program not needed at any given time to meet the then current bond retirement schedules and operating costs have financed the purchase of farms and homes since the Program's inception. Expenditures are primarily for debt service and administration of the Program.

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 percentage change.

	2008	2007	Change	% Change
ASSETS				
Cash, cash equivalents and investments	$ 566,111	$ 677,330	$ (111,219)	(16.4)%
Receivables under contracts of purchase—net	1,664,908	1,521,426	143,482	9.4 %
Other receivables and assets	59,282	54,804	4,478	8.2 %
TOTAL ASSETS	$ 2,290,301	$ 2,253,560	$ 36,741	1.6 %
LIABILITIES AND FUND EQUITY				
Liabilities:				
Bonds payable	$ 2,035,092	$ 1,992,718	$ 42,374	2.1 %
Other payables and liabilities	33,346	35,196	(1,850)	(5.3)%
Total liabilities	2,068,438	2,027,914	40,524	2.0 %
Fund Equity	221,863	225,646	(3,783)	(1.7)%
TOTAL LIABILITIES AND FUND EQUITY	$ 2,290,301	$ 2,253,560	$ 36,741	1.6 %

Assets

Total assets increased by $36.7 million from $2.254 billion at June 30, 2007 to $2.290 billion at June 30, 2008. This increase consisted primarily of the following items:

- Total cash, cash equivalents and investments decreased by $111 million from $677 million at June 30, 2007 to $566 million at June 30, 2008. The decrease is a direct result of an increase in the loan portfolio.

- Net receivables under contracts of purchase increased by $143.4 million from $1.521 billion at June 30, 2007 to $1.665 billion at June 30, 2008. The change was due to higher interest rates and tightened credit standards in the general housing market, which made the Program's loans more attractive to veterans, causing an increase in loan originations and reduced prepayments. while high property values in California resulted in larger individual loans.

- All other receivables and assets increased by $4.5 million from $54.8 million at June 30, 2007 to $59.3 million at June 30, 2008.

Liabilities and Fund Equity

Total liabilities increased by $41 million from $2.028 billion at June 30, 2007 to $2.069 billion at June 30, 2008, principally due to the issuance of bonds in current fiscal year.

Fund equity decreased by $3.8 million from $225.6 million at June 30, 2007 to $221.8 million at June 30, 2008, as a result of the excess of expenses over revenue.

The total assets to liability ratio remained unchanged at 1.11 as of June 30, 2008 and June 30, 2007.

Condensed Statements of Revenues and Expenses

The following table presents condensed statements of revenues and expenses for the Fund for the fiscal years ended June 30, 2008 and June 30, 2007 (dollars in thousands) and the percentage change.

	2008	2007	Change	% Change
PROGRAM OPERATIONS:				
Interest revenues:				
Contracts of purchase	$ 93,234	$ 88,424	$ 4,810	5.4 %
Investments and other	29,492	32,410	(2,918)	(9.0)%
Total program operating revenues	122,726	120,834	1,892	1.6 %
Expenses:				
Interest expense	108,211	106,641	1,570	1.5 %
Change in allowance for uncollectible contracts	2,115	1,421	694	48.8 %
Total program operating expenses	110,326	108,062	2,264	2.1 %
Excess of program operations revenues over program operations expenses	12,400	12,772	(372)	(2.9)%
PROGRAM ADMINISTRATION:				
Total program administration revenues	2,053	4,953	(2,900)	(58.6)%
Total program administration expenses	17,274	15,547	1,727	11.1 %
Excess of program administration expenses over program administration revenues	(15,221)	(10,594)	(4,627)	43.7 %
Operations excess (deficiency) of revenues over (under) expenses	(2,821)	2,178	(4,999)	(229.5)%
(Loss) gain on sale of repossessed property	(962)	165	(1,127)	(683.0)%
(Deficiency) excess of revenues (under) over expenses	$ (3,783)	$ 2,343	$ (6,126)	(261.5)%

Program Operations

Program operations revenues in excess of program operations expenses decreased $0.4 million from $12.8 million compared to $12.4 million for the fiscal year ended June 30, 2007 and 2008, respectively, due to the following:

- Interest revenue from contracts of purchase increased by $4.8 million from $88.4 million for the year ended June 30, 2007 to $93.2 million for the year ended June 30, 2008, due to the replacement of lower rate contracts with new contracts with larger loan amounts at higher interest rates.

- Interest revenues on investments decreased by $2.9 million from $32.4 million for the year ended June 30, 2007 to $29.5 million for the year ended June 30, 2008. This decrease is due to the SMIF quarterly interest rate decreasing over the fiscal year from 5.24% at June 30, 2007 to 3.11% at June 30, 2008 combined with a decrease in the cash, cash equivalents and investments during that time.

- Net program operation expenses increased $2.3 million from $108.0 the year ended June 30, 2007 to $110.3 million for the year ended June 30, 2008. The increase is due to an increase of $1.5 million in interest expense related to an in increase in bonds outstanding and a $.7 million increase in the allowance for uncollectible contracts of purchase.

Program Administration

Total program administration revenues include loan origination fees paid to the Department, loan guarantee fees collected by the Department to be applied, in part, to the purchase of private mortgage insurance and premiums collected by the department for the fire and hazard insurance program. Total program administration revenues decreased by $2.8 million from $4.9 million for the year ended June 30, 2007 to $2.1 million for the year ended June 30, 2008, due to the following:

- The fire and hazard insurance program experienced a net increase in costs of $2.5 million related to the California wildfires

- Other income decreased by $0.8 million, offset by an increase of $0.5 million related to loan origination fees.

Total program administration expenses increased by $1.7 million from $15.6 million for the year ended June 30, 2007 to $17.3 million for the year ended June 30, 2008. The increase is due to an increase of payroll and other support expenditures related to the passage of HR6081 *Heroes Earnings Assistance and Relief Tax Act of 2008* and HR3221 *Housing and Economic Recovery Act of 2008* (the "Legislation").

The sale of repossessed properties resulted in a loss of $1.0 million for the year ended June 30, 2008 compared to a gain of $.2 million for the year ended June 30, 2007 due to a reduction in property values from loans made in the calendar years 2005 and 2006. The Funds' holdings of repossessed properties, net of allowances for losses increased from $4.1 million as of June 30, 2007 to $10.6 million as of June 30, 2008.

Economic Factors Facing Veterans Farm & Home Building Fund of 1943

At June 30, 2008, the Program's loan portfolio balance was at approximately $1.665 billion, an increase of $143 million, or 9.4%, from $1.521 billion at June 30, 2007. During the fiscal year, cash and investments balance decreased $111 million, or 16.4%, from a balance of $677 million to $566 million. Bonds payable increased $42 million, or 2.1%, from $1.993 billion at June 30, 2007 to $2.035 billion at June 30, 2008. Bond ratings for the Department's GO bonds are AA-, A1 and A+ by rating agencies Standard & Poor's, Moody's and Fitch, respectively. Bond ratings for the Department's Revenue bonds are AA-, Aa2 and AA- by Standard & Poor's, Moody's and Fitch, respectively.

The passage of the Legislation has increased the number of veterans eligible to apply to CalVet for housing loans and makes future bond issues exempt from the alternative minimum tax calculation.

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 percentage change.

	2007	2006	Change	% Change
ASSETS				
Cash, cash equivalents and investments	$ 677,330	$ 573,053	$ 104,277	18.2 %
Receivables under contracts of purchase—net	1,521,426	1,503,802	17,624	1.2 %
Other receivables and assets	54,804	55,785	(981)	(1.8)%
TOTAL ASSETS	$ 2,253,560	$ 2,132,640	$ 120,920	5.7 %
LIABILITIES AND FUND EQUITY				
Liabilities:				
Bonds payable	$ 1,992,718	$ 1,868,478	$ 124,240	6.6 %
Other payables and liabilities	35,196	40,859	(5,663)	(13.9)%
Total liabilities	2,027,914	1,909,337	118,577	6.2 %
Fund Equity	225,646	223,303	2,343	1.0 %
TOTAL LIABILITIES AND FUND EQUITY	$ 2,253,560	$ 2,132,640	$ 120,920	5.7 %

Assets

Total assets increased by $121 million from $2.132 billion at June 30, 2006 to $2.253 billion at June 30, 2007. This increase consisted primarily of the following items:

- Total cash, cash equivalents and investments increased by $104 million from $573 million at June 30, 2006 to $677 million at June 30, 2007. The increase was due to $129.7 million of net cash provided by proceeds from the sale of bonds less maturities and early redemptions, offset by an increase of $18 million in receivables under contracts of purchase and $7.7 million for operational activities.

- Net receivables under contracts of purchase increased by $18 million from $1.503 billion at June 30, 2006 to $1.521 billion at June 30, 2007. The change was due to rising interest rates in the housing market, which made the Program's loans more attractive to veterans, causing an increase in loan originations and reduced prepayments, while high property values in California resulted in larger individual loans.

- All other receivables and assets decreased by $1 million from $55.8 million at June 30, 2006 to $54.8 million at June 30, 2007.

Liabilities and Fund Equity

Total liabilities increased by $119 million from $1.909 billion at June 30, 2006 to $2.028 billion at June 30, 2007. The net increase was due to the issuance of bonds in current fiscal year, offset by a decrease in the insurance claims payable and loss reserves.

Fund equity increased by $2.3 million from $223.3 million at June 30, 2006 to $225.6 million at June 30, 2007, as a result of the excess of revenue over expenses of $2.3 million.

The total assets to liability ratio changed to 1.11 as of June 30, 2007, from 1.12 as of June 30, 2006.

Condensed Statements of Revenues and Expenses

The following table presents condensed statements of revenues and expenses for the Fund for the fiscal years ended June 30, 2007 and June 30, 2006 (dollars in thousands) and the percentage change.

	2007	2006	Change	% Change
PROGRAM OPERATIONS:				
Interest revenues:				
Contracts of purchase	$ 88,424	$ 84,527	$ 3,897	4.6 %
Investments and other	32,410	29,921	2,489	8.3 %
Total program operating revenues	120,834	114,448	6,386	5.6 %
Expenses:				
Interest expense	106,641	111,434	(4,793)	(4.3)%
Change in allowance for uncollectible contracts	1,421	(450)	1,871	(415.8)%
Total program operating expenses	108,062	110,984	(2,922)	(2.6)%
Excess of program operations revenues over program operations expenses	12,772	3,464	9,308	268.7 %
PROGRAM ADMINISTRATION:				
Total program administration revenues	4,953	8,133	(3,180)	(39.1)%
Total program administration expenses	15,547	20,630	(5,083)	(24.6)%
Excess of program administration expenses over program administration revenues	(10,594)	(12,497)	1,903	(15.2)%
Operations excess (deficiency) of revenues over (under) expenses	2,178	(9,033)	11,211	(124.1)%
Gain on sale of repossessed property	165	204	(39)	(19.1)%
Excess (deficiency) of revenues over (under) expenses	$ 2,343	$ (8,829)	$ 11,172	(126.5)%

Program Operations

Interest revenue from contracts of purchase increased by $3.9 million from $84.5 million for the year ended June 30, 2006 to $88.4 million for the year ended June 30, 2007, due to the replacement of lower rate contracts with new contracts at higher interest rates.

Interest revenues on investments increased by $2.5 million from $29.9 million for the year ended June 30, 2006 to $32.4 million for the year ended June 30, 2007. This increase was due to the SMIF quarterly interest rate increasing over the fiscal year from 4.53% at June 30, 2006 to 5.24% at June 30, 2007.

Interest expense decreased by $4.8 million from $111.4 million for the year ended June 30, 2006 to $106.6 million for the year ended June 30, 2007. The decrease was due to a reduction in bonds outstanding, combined with the savings achieved by the refunding of outstanding bonds to lower interest rates near the end of the year ended June 30, 2007.

Program operations revenues in excess of program operations expenses increased $9.3 million from $3.5 compared to $12.8 million for the fiscal year ended June 30, 2006 and 2007, respectively. This program improvement is due to an increase in interest from contracts of purchase and investment earnings, offset by a decrease in interest expense.

Program Administration

Total program administration revenues include loan origination fees paid to the Department, loan guarantee fees collected by the Department to be applied, in part, to the purchase of private mortgage insurance, other miscellaneous fees collected from program participants, rental income, and certain reimbursements of prior expenses, among others. Revenues decreased by $3.3 million from $8.1 million for the year ended June 30, 2006 to $4.8 million for the year ended June 30, 2007.

Total program administration expenses decreased by $5.2 million from $20.6 million for the year ended June 30, 2006 to $15.5 million for the year ended June 30, 2007. The decrease is due to a reduction of payroll and other support expenditures as well as a reduction in the reserve requirement for the self-insured life and disability program.

Gain on sale of repossessed properties decreased marginally compared to the same fiscal period in the prior year. The decrease was due to higher principal loan balances, which more closely reflected the current housing market values, thereby reducing the overall gains as compared to the prior fiscal year. The Department's holdings of repossessed properties increased from $1 million as of June 30, 2006 to $4.1 million as of June 30, 2007.

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

BALANCE SHEETS
JUNE 30, 2008 AND 2007 (in thousands)

	2008	2007 (Restated see Note 11)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents:		
Cash in State Treasury	$ 15,178	$ 9,904
State of California's Surplus Money Investment Fund	518,688	631,001
Total cash and cash equivalents	533,866	640,905
Current portion of receivables under contracts of purchase—net of allowance for uncollectible contracts	49,133	47,717
Interest receivables:		
Contracts of purchase	8,712	7,688
State of California's Surplus Money Investment Fund	4,267	6,891
Other investments	125	126
Total interest receivables	13,104	14,705
Total current assets	596,103	703,327
NONCURRENT ASSETS:		
Investments:		
Guaranteed investment contracts	25,842	30,101
Insurance administrators	6,403	6,324
Total investments	32,245	36,425
Receivables under contracts of purchase—net of allowance for uncollectible contracts	1,615,775	1,473,709
Due from Veterans Debenture Revenue Fund	32,132	32,112
Other real estate owned, net of allowance for losses of $1,994 and $1,055, respectively	10,625	4,138
Land, improvements and equipment—net of accumulated depreciation of $15,723 and $15,177, respectively	570	1,084
Other noncurrent assets	2,851	2,765
Total noncurrent assets	1,694,198	1,550,233
TOTAL	$ 2,290,301	$ 2,253,560
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES:		
Bonds payable—current portion	$ 97,015	$ 155,380
Accrued interest and other liabilities	24,171	23,870
Due to other funds	586	1,272
Fire and hazard insurance claims payable	1,504	1,173
Total current liabilities	123,276	181,695
NONCURRENT LIABILITIES:		
Bonds payable—noncurrent portion	1,938,077	1,837,338
Other postemployment benefits	324	
Self-insured life and disability insurance loss reserve	6,761	8,881
Total noncurrent liabilities	1,945,162	1,846,219
Total liabilities	2,068,438	2,027,914
COMMITMENTS AND CONTINGENCIES (Note 9)		
FUND EQUITY—Unrestricted	221,863	225,646
TOTAL	$ 2,290,301	$ 2,253,560

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

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

	2008	2007
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of purchase of properties	$ 93,234	$ 88,424
Investments and other	27,809	30,697
Transfers of revenue from Veterans Debenture Revenue Fund	1,683	1,713
Total program operations revenues	122,726	120,834
Expenses:		
Interest expense	108,211	106,641
Change in allowance for uncollectible contracts	2,115	1,421
Total program operations expenses	110,326	108,062
Excess of program operations revenue over program operations expenses	12,400	12,772
PROGRAM ADMINISTRATION:		
Revenues:		
Loan fees	2,932	2,401
Other income	264	1,106
Net (expense) revenue—Fire and hazard insurance program	(1,200)	1,308
Net revenue—Self-insured life and disability insurance program	57	138
Total program administration revenues	2,053	4,953
Expenses:		
Payroll and related costs	9,703	8,529
General and administrative expenses	7,571	7,018
Total program administration expenses	17,274	15,547
Deficiency of program administration revenue under program administration expenses	(15,221)	(10,594)
Operations (deficiency) excess of revenues (under) over expenses	(2,821)	2,178
NONOPERATING REVENUE—(Loss) gain on sale of repossessed property	(962)	165
(Deficiency) excess of revenues (under) over expenses	(3,783)	2,343
FUND EQUITY:		
Beginning of year	225,646	223,303
End of year	$ 221,863	$ 225,646

See notes to financial statements.

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

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007 (in thousands)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from contract holders	$ 8,280	$ 11,217
Interest received	122,643	116,553
Interest payments	(112,187)	(106,003)
Payments to suppliers and employees	(23,787)	(34,673)
Other receipts	(5,065)	5,256
Net cash used for operating activities	(10,116)	(7,650)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from sales of bonds	191,200	735,235
Maturities of bonds payable	(75,195)	(123,555)
Early redemption of bonds payable	(72,605)	(481,975)
Increase to deferred finance costs	(2,145)	(6,211)
Net decrease (increase) in due from Veterans Debenture Revenue Fund	(20)	5,653
Net cash provided by noncapital financing activities	41,235	129,147
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase in receivables under contracts of purchase	(142,306)	(17,106)
Decrease in guaranteed investment contracts	4,180	90,255
Purchase of land, improvements and equipment	(32)	(115)
Net cash (used in) provided by investing activities	(138,158)	73,034
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(107,039)	194,531
CASH AND CASH EQUIVALENTS:		
Beginning of year	640,905	446,374
End of year	$ 533,866	$ 640,905
RECONCILIATION OF (DEFICIENCY) EXCESS OF REVENUES (UNDER) OVER EXPENSES TO NET CASH USED FOR OPERATING ACTIVITIES:		
(Deficiency) excess of revenues (under) over expenses	$ (3,783)	$ 2,343
Adjustments to reconcile to net cash used by operating activities:		
Bond amortization	1,119	746
Change in allowance for uncollectible contracts	(2,115)	(1,421)
Depreciation	546	751
Loss (gain) on sale of repossessed property	962	(165)
Effect of changes in assets and liabilities:		
(Decrease) increase in interest receivable—State of California's Surplus Money Investment Fun	2,624	(1,520)
Decrease in interest receivable—other investments	1	425
(Increase) decrease in interest receivable—contracts of purchase	(1,024)	(1,024)
Increase in other real estate owned	(6,510)	(2,022)
Increase in other assets	(86)	(100)
Increase (decrease) in accrued interest and other liabilities	301	(1,785)
(Decrease) increase in due to other funds	(686)	76
Increase in other postemployment benefits	324	-
Increase (decrease) in fire and hazard insurance claims payable	331	(1,427)
Decrease in self-insured life and disability insurance loss reserve	(2,120)	(2,527)
NET CASH USED FOR OPERATING ACTIVITIES	$ (10,116)	$ (7,650)

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description—The California Department of Veterans Affairs (the "Department") is a separate legal entity and 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, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the "Fund") was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenses are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, 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.

Basis of Accounting—The Fund has been classified as a proprietary fund for accounting purposes. Revenues are recorded when earned and expenses are recognized as incurred.

Accounting and Reporting Standards—The Fund follows the *Standards of Governmental Accounting and Financial Reporting*, as promulgated by the *Governmental Accounting Standards Board* ("GASB"). The Fund has adopted the option under Governmental Accounting Standards Board Statement No. 20 (GASB No. 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Funds Accounting*, which allows the Fund to apply all GASB pronouncements and only *Financial Accounting Standards Board* ("FASB") pronouncements which date prior to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARBs") of the Committee on Accounting Procedures.

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 amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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—The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued at cost. The fair value of investments is based on published market prices and quotations from major investment brokers. Uncommitted bond proceeds for loans to veterans are reflected in the balance sheet within the investments balance.

Receivables under Contracts of Purchase—Receivables under contracts of purchase consist of the remaining contract principal balance net of the allowance for uncollectible contracts.

Allowance for Uncollectible Contracts—The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectability and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation. The allowance for uncollectible contracts was $9,743,000 and 8,567,000 as of June 30, 2008 and 2007, respectively.

Contract Guarantees and Primary Mortgage Insurance—The Department collects a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value ("HLTV") contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs ("USDVA") or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance ("PMI") from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned—Real estate acquired by the Fund by repossession is recorded at the lower of estimated fair value less estimated selling costs (fair value) or the carrying value of the related loan at the date of foreclosure. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses. Operating costs on foreclosed real estate are expensed as incurred. Costs incurred for physical improvements to foreclosed real estate are capitalized if the value is recoverable through future sale.

Fire and Hazard Insurance Plan—This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred is included as a net amount in the statement of revenues, expenses and changes in fund equity. Fire and hazard insurance claims payable include unpaid claims and incurred but not reported claims.

Self-Insured Life and Disability Insurance Plan—Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan, which include future disability and life benefits were derived from an actuarial evaluation performed in 2006 that is updated internally on an annual basis. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%. Self-insured life and disability insurance loss reserve include unpaid claims, incurred but not reported claims and loss reserve.

Amortization of Bond Premiums, Discounts and Issuance Costs—Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

Recently Adopted Accounting Standard—In fiscal year 2007-2008, the Fund adopted a new statement issued by the Governmental Accounting Standards Board ("GASB").

GASB Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* ("GASB 45"). As stated in GASB 45, this Statement establishes standards for the measurement, recognition, and display of OPEB costs and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (e.g., life insurance) when provided separately from a pension plan. GASB 45 improves the relevance and the usefulness of financial reporting by: (i) recognizing the cost of benefits in periods when the related services are received by the employer; (ii) providing information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded; (iii) providing information useful in assessing potential demands on the employer's future cash flows.

The financial reporting impact resulting from the implementation of GASB 45 for fiscal year 2008 was the recognition of an additional expense and liability of $324,000 in the Fund's financial statements for fiscal year 2007-2008 (see Note 10).

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. At June 30, 2008 and 2007, the carrying amount of the Fund's deposits in State Treasury was $15,178,000 and $9,904,000, respectively.

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. At June 30, 2008 and 2007, the carrying amount of the Fund's deposits in SMIF was $518,688,000 and $631,001,000, respectively.

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 investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law. The Department monitors the credit worthiness of all companies that hold investments of the Fund.

The Fund's investment agreements, carried at cost, were $25,842,000 and $30,101,000 as of June 30, 2008 and 2007, respectively. The interest rates on investment agreements are fixed and range from 5.30% to 6.46%. The investment agreements expire from 2009 to 2032.

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 earnings 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 amounts administered by the insurance company and 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 (in thousands):

	2008	2007
Category 1		
Amounts held in trust fund with insurance administrators	$ 6,403	$ 6,324
Investment agreements (at cost)	25,842	30,101
Total investment	$ 32,245	$ 36,425

3. RECEIVABLES UNDER CONTRACTS OF PURCHASE

The Fund retains title to all real property subject to contracts of purchase until the contract is satisfied. The veterans' contracts have original terms of 25-30 years and bear interest at rates of 4.25% to 9.75%, depending on the age and type of contract and the classification of the contract holder. Receivables under contracts of purchase, net of allowance for uncollectible contracts were as follows at June 30, 2008 and 2007 (in thousands):

	2008	2007
Recievables under contracts of purchase	$ 1,674,651	$ 1,529,993
Less allowance for uncolletible contracts of purchase	(9,743)	(8,567)
	1,664,908	1,521,426
Less current portion	(49,133)	(47,717)
Recievables under contracts of purchase—net	$ 1,615,775	$ 1,473,709

4. LAND, IMPROVEMENTS, AND EQUIPMENT

As of June 30, 2008 and 2007, land, improvements and equipment consisted of the following (in thousands):

	2008	2007
Land	$ 443	$ 443
Buildings	12,410	12,410
Equipment	3,440	3,408
	16,293	16,261
Less accumulated depreciation	(15,723)	(15,177)
Land, improvements, and equipment—net	$ 570	$ 1,084

5. BONDS PAYABLE

At June 30, 2008 and 2007, bonds payable included the following (in thousands):

	2008	2007
General obligation bonds of the State of California, fixed annual interest rates from 4.2% to 11.0% due in varying annual installments through 2040 (subject to varying redemption provisions)	$ 1,324,595	$ 1,319,470
Home purchase revenue bonds, fixed annual interest rates from 2.14% to 6.15%, due in varying annual installments through 2042 (subject to varying redemption provisions)	717,010	673,235
Commercial Paper, due to the State of California, due in full December 2008	10,500	16,000
Total	2,052,105	2,008,705
Less:		
Discounts	(2,025)	(2,137)
Premium	268	283
Unamortized bond origination costs	(14,064)	(12,843)
Unamortized bond redemption premiums	(1,192)	(1,290)
Total	2,035,092	1,992,718
Less—current portion	97,015	155,380
Noncurrent portion	$ 1,938,077	$ 1,837,338

A summary of debt service requirements for the next five years and to maturity is as follows (in thousands):

Fiscal Year Ending June 30	Principal	Interest
2009	97,015	104,719
2010	68,050	97,573
2011	35,025	92,422
2012	49,455	90,009
2013	27,540	88,203
2014-2018	311,320	398,901
2019-2023	389,190	310,070
2024-2028	467,425	206,220
2029-2033	369,290	102,641
2034-2038	157,675	37,572
2039-2043	80,120	7,706
Total	$2,052,105	$1,536,036

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. The authorized and unissued bonds under the Veterans Bond Act of 2000 were $263,610,000 at June 30, 2008 and $365,310,000 at June 30, 2007.

Home Purchase Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the $1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 2008 and 2007, authorized and unissued revenue bonds were $782,990,000 and $826,765,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least 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, and 2001 Series A Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds, and for series 2002 an amount equal to five percent of the outstanding principal amount. 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 Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2008 and 2007, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

6. BOND REFUNDING

For the year ended June 30, 2008, the Department issued General Obligation bonds and Home Purchase Revenue bonds totaling $91,200,000 and $100,000,000, respectively. The Fund did not economically refund any of its bond indebtedness with the new money.

For the year ended June 30, 2007, the Department issued General Obligation bonds totaling $359,160,000 of which $50,275,000 was new money and the remainder was used to refund previously issued general obligation bonds. The Department also issued Home Purchase Revenue bonds totaling $376,075,000, of which $139,715,000 was new money and $236,360,000 was used to refund previously issued Home Purchase Revenue bonds. The average interest rates on the new money home purchase revenue bonds and the home purchase revenue refunded bonds was 4.98% and 4.60%, respectively. The Department decreased its total debt service payments over the next 26 years by approximately $27,481,000, thereby realizing an economic gain (difference between the present values of the debt service payment on the old and new debt adjusted by cost of issuance) of $26,654,000 in connection with the refunding.

7. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for all of the single-family detached homes subject to the CalVet contracts of sale. The program is funded by amounts charged to contract holders, which are considered appropriate to cover losses incurred, the premiums paid for excess insurance coverage, claims adjusting costs and administration fees. From the amounts charged to the contract holders, the Department pays losses up to a $2,500,000 deductible, with an annual aggregate deductible of $13,000,000. Several insurance carriers supply an additional $50,000,000 of coverage in excess of these deductibles. The claims loss expense is based on our third party administrator's estimate of incurred but not reported claims, which is based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 2008 and 2007, was as follows (in thousands):

	2008	2007
Amounts charged to contract holders	$ 5,271	$ 5,414
Less:		
Claims loss expense	(5,379)	(2,912)
Master policy premium	(782)	(848)
Administrative fees	(310)	(293)
Third party contract-replacement value project		(53)
Net revenue—Fire and hazard insurance program	$ (1,200)	$ 1,308

8. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. Except for existing contract holders receiving benefits at that date, the self-insured life and disability protection plan were replaced by existing life and disability insurance plans provided by commercial insurers.

As of June 30, 2008, the Department remains self-insured for approximately 223 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid-off. Loss reserves for these obligations have been actuarially determined.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverage continues as obligations of the self-funded life and disability protection plan for the years ended June 30, 2008 and 2007, was as follows (in thousands):

	2008	2007
Claims expenses:		
Life insurance program	$ (162)	$ (200)
Disability insurance program	(1,954)	(2,241)
Total claims expenses	(2,116)	(2,441)
Decrease in estimated loss reserves	2,120	2,519
Net claims revenue and change in loss reserves	4	78
Plan revenues:		
Life insurance program	19	26
Disability insurance program	58	63
Total	77	89
Administrative fees	(24)	(29)
Net revenue—Self-insured life and disability insurance program	$ 57	$ 138

The change in the self-insured life and disability insurance loss reserve for the years ended June 30, 2008 and 2007, was as follows (in thousands):

	2008	2007
Self-insured life and disability insurance loss reserve—beginning of year balance	$ 8,881	$ 11,408
Insurance claims payable	-	(8)
Change in estimated loss reserve	(2,120)	(2,519)
Self-insured life and disability insurance loss reserve—end of year balance	$ 6,761	$ 8,881

9. COMMITMENTS AND CONTINGENCIES

Commitments—As of June 30, 2008, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $86,433,022.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2008 and 2007, was $239,713 and $248,043, respectively. As of June 30, 2008, minimum annual rentals under operating leases are as follows (in thousands):

2009	162
2010	102
2011	24
Total	$ 288

Contingencies—The Fund is subject to a variety of legal actions arising out of the normal course of business. Based upon information available to the Fund, its review of such lawsuits and consultation with legal counsel, the Fund believes the liability relating to these actions, if any, would not have a material adverse effect on the Fund's financial statements.

10. EMPLOYEE BENEFIT PLANS

Public Employees' Retirement Fund

Plan Description—The Fund contributes to the Public Employees' Retirement Fund ("PERF") as part of the State of California, the primary government. The PERF is a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employment Retirement System ("CalPERS"). CalPERS provides retirement, death, disability, and post retirement health care benefits to members as established by state statue. CalPERS issues a publicly available Comprehensive Annual Financial Report ("CAFR") that includes financial statements and required supplementary information for the Public Employees' Retirement Fund. A copy of that report may be obtained from CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 95229-2715 or via the internet at www.calpers.ca.gov.

Funding Policy—Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State 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 5% of compensation in excess of $513 each month.

Contributions by the Department to the Plan for the years ended June 30, 2008 and 2007 were approximately $1,023,000 and $962,000, or approximately 15.5% and 15.8% of participants' salaries, respectively.

Annual Pension Cost—For fiscal year June 30, 2008 and 2007 the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution is determined by actuarial valuation using the entry age normal actuarial cost method. The most recent actuarial valuation available is as of June 30, 2007, which actuarial assumptions included (a) 7.75% investment rate of return compounded annually, (b) projected salary increases that vary based on duration of service, and (c) overall payroll growth factor of 3.25% annually. Both (a) and (b) included an inflation component of 3.0% and a 0.25% per annum productivity increase assumption. The actuarial value of CalPERS assets attributable to the Department was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a two to five-year period.

The most recent actuarial valuation of the PERF indicated that there was an unfunded actuarial accrued liability. The amount of the under-funded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due, is presented in the June 30, 2007, CalPERS CAFR.

State of California Other Postemployment Benefit Plans

Plan Description—The Fund contributes to the State of California Other Postemployment Benefit Plans ("SCOPEB") as part of the State of California, the primary government. The SCOPEB is a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the State of California and CalPERS. CalPERS provides retirement, death, disability, and post retirement health care benefits to members as established by state statue. CalPERS issues a publicly available CAFR that includes financial statements and required supplementary information for the SCOPEB. A copy of that report may be obtained from CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 95229-2715 or via the internet at www.calpers.ca.gov.

Funding Policy—The State Controller's Office sets the employer contribution rate based on the annual required contribution of the employers (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The Fund's estimated unfunded other post-employment benefit cost was $324,000 and $0 for the years ended June 30, 2008 an 2007, respectively.

11. RESTATEMENT

Subsequent to the issuance of the Fund's 2007 financial statements, management determined that the majority of receivables under contracts of purchase should be classified as a noncurrent asset. Previously all receivables under contracts of purchase were classified as a current asset. As a result, the balance sheet of the Fund, as of June 30, 2007, has been restated to present the current and non-current amounts of the receivables under contracts of purchase. There was no change to the total assets of the balance sheet of the Fund, as of June 30, 2007. The effect of this restatement on the Fund's 2007 financial statements is as follows:

	As Previously Reported	As Restated
Current Assets		
Receivables under contracts of purchase—net of allowance for uncollectible contracts	$ 1,521,426	
Current portion of receivables under contracts of purchase—net of allowance for uncollectible contracts		$ 47,717
Noncurrent Assets		
Receivables under contracts of purchase—net of allowance for uncollectible contracts		$ 1,473,709

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