

AUDITOR-CONTROLLER COUNTY OF ORANGE

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December 16, 2003

Honorable Board of Supervisors County of Orange Santa Ana, California

The Comprehensive Annual Financial Report (CAFR) of the County of Orange, State of California, for the fiscal year ended June 30, 2003, is hereby submitted in accordance with the provisions of Sections 25250 and 25253 of the Government Code of the State of California. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the County. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and changes in financial position of the various funds of the County. All disclosures necessary to enable the reader to gain an understanding of the County's financial activities have been included.

The CAFR was prepared to satisfy the financial reporting requirements for state and local governments issued by the Governmental Accounting Standards Board (GASB), specifically GASB Statement No. 34 "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" (GASB 34), and subsequent related statements issued by GASB. GASB Statement No. 34 requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of a Management's Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

The CAFR has been audited by the independent certified public accounting firm of Macias, Gini & Company LLP. The goal of the independent audit was to provide reasonable assurance about whether the basic financial statements of the County of Orange for the fiscal year ended June 30, 2003, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall basic financial statement presentation. The independent certified public accounting firm concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County of Orange's financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund and the aggregate remaining fund information, which collectively comprise the basic financial statements, as of and for the fiscal year ended June 30, 2003, present fairly, in all material respects, the financial position, changes in financial position and cash flows, where applicable, of the County of Orange in conformity with generally accepted accounting principles.

The County is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and the U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Information related to this single audit, including the Schedule of Expenditures of Federal Awards, Findings and Questioned Costs, and the independent auditor's reports on internal control and compliance with applicable laws and regulations, are included in a separate annual publication.

Copies of this CAFR, the Single Audit Report, the County Proposed and Final Budgets, booklets specifying the tax rates and assessed valuations of taxing agencies in Orange County, and financial reports of certain funds or functions for which the County has fiduciary responsibility, may be obtained from the office of the County Auditor-Controller.

PROFILE OF THE GOVERNMENT

The County of Orange, incorporated in 1889 and located in the southern part of the State of California, is one of the major metropolitan areas in the state and nation. Orange County occupies a land area of 798 square miles with a coastline of 42 miles serving a population of approximately 3 million. It represents the second most populous county in the state, and ranks fifth in the nation.



The County of Orange is a charter county as a result of the March 5, 2002 voter approval of Measure V, which provides for an electoral process to fill mid-term vacancies on the Board of Supervisors. Before Measure V, as a general law county, mid-term vacancies would otherwise be filled by gubernatorial appointment. In all other respects, the County is like a general law county. The County is governed by a

five-member Board of Supervisors, who each serve four-year terms, and annually elect a Chairman and Vice-Chairman. The supervisors represent districts that are each equal in population. The district boundaries were revised effective September 14, 2001, incorporating the results of the 2000 census. A County Executive Officer (CEO) directly or indirectly oversees 22 County Departments, six of which have elected department heads. The preceding Supervisorial Districts map shows the boundaries of Orange County and the area governed by each member of the Board of Supervisors.

The County provides a full range of services, including countywide services, unincorporated area services, and contract services for cities. These services are outlined in the following table:

Countywide Services	
Affordable Housing (Housing Authority)	Indigent Medical Services
Agricultural Commissioner	Jails & Juvenile Facilities
Airport	Juvenile Justice Commission
Child Protection & Social Services	Landfills & Solid Waste Disposal
Clerk-Recorder	Law Enforcement
Coroner & Forensic Services	Probationary Supervision
District Attorney	Public Administrator/Guardian
Elections & Voter Registration	Public Assistance
Environmental Health	Public Defender/Alternate Defense
Family Support Collection	Public & Mental Health
Flood Control & Transportation	Tax Assessment & Collection
Grand Jury	Weights & Measures
Harbors, Beaches & Parks	

Unincorporated Area Services	Contract Services for Cities
Animal Control	Animal Control
Land Use	Law Enforcement
Law Enforcement	Libraries
Libraries	Public Works & Engineering
Parks	
Public Works & Engineering	
Roads	
Surveyor	
Water Disposal Collection	

In addition to these services, the County is also financially accountable for the reporting of component units. Blended component units, although legally separate entities, are, in substance, part of the County's operations, and therefore data from these units are combined with data of the County. The County has one component unit, the Orange County Children and Families Commission (OCCFC), which requires discrete presentation in the government-wide financial statements. The following entities are presented as blended component units in the basic financial statements for the fiscal year ended June 30, 2003: the Orange County Flood Control District, Orange County Development Agency, Orange County Housing Authority, Orange County Financing Authority, Orange County Special Financing Authority, Orange County Public Financing Authority, Orange County Public Facilities Corporation, and certain special districts. Additional information on these entities can be found in Note 1.A in the Notes to the Basic Financial Statements.

The County maintains budgetary controls to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Board. Activities of the General Fund and most of the Special Revenue, Debt Service, and Capital Projects funds are included in the annual appropriated budget. The level of budgetary control (that level which cannot be exceeded without action by the Board) is at the legal fund-agency unit level, which represents a department or an agency. Budget-to-actual comparisons are provided in this report for each governmental fund for which an appropriated annual

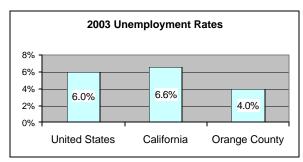
budget has been adopted. The Budgetary Comparison Statement for the General Fund and Major Special Revenue Funds are part of the Basic Financial Statements. For Nonmajor Governmental Funds with appropriated annual budgets, this comparison is presented in the Supplementary Information for governmental funds. The County also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered appropriations do not lapse at year-end; encumbrances outstanding at that time are reported as reservations of fund balance for the following year's budget. Additional information on the budgetary process can be found in Note 1.D in the Notes to the Basic Financial Statements.

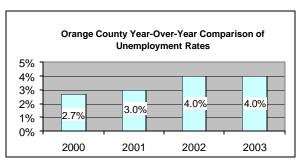
The County of Orange Internet Site at http://www.oc.ca.gov provides extensive information about County government and its services to the citizens of Orange County and others who visit our web pages. Approximately 300,000 visits are made to the Orange County web site each month and those visitors view over 1 million pages of information. The County's website includes information about the Board of Supervisors, email to Board offices, Board Agendas, County job listings, purchasing bid solicitations, County directories and general information, assessment appeals, links to court information and local court rules, voter information, County permits and forms, financial information such as the County tax rate book, the budget, and the five most recent CAFRs. The site also provides several online services, including the ability to listen to Board meetings live and archived, online public comments to Board agendas, County purchasing online, ordering birth, death and marriage certificates online, performing a fictitious business name search, and looking up election results and polling places. The County continues to improve the website by increasing citizen's ability to conduct business online with the County. This year, the Center for Digital Government ranked the County of Orange fourth in the nation for providing superb ecommerce services to our constituents. The County of Orange also won the Center for Digital Government national "Best of Breed" award for On-Line Employment Application Services.

FACTORS AFFECTING FINANCIAL CONDITION

Local Economy

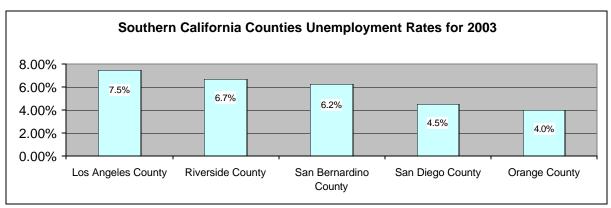
The state of Orange County's economy can be measured by two indictors: how well the local economy is performing relative to surrounding counties, the state and the nation (external indicators) and how well the local economy is performing relative to its own historical trends (internal indicators). In terms of the external indicators, Orange County's economy routinely out-performs local surrounding counties, the state, and national economies (in annual percentage growth), and, in fact, ranks higher (in absolute dollars) than the economies of the majority of the countries in the world. Current external indicators show that despite the current slowdown of the local economy, conditions in Orange County are expected to remain favorable relative to conditions in surrounding counties, the state and nation. However, in terms of internal indicators, Orange County's economic performance is much more volatile and uncertain. This section provides various external and internal indicators that describe the current and projected outlook of the Orange County economy.





Source: State of California, Employment Development Department

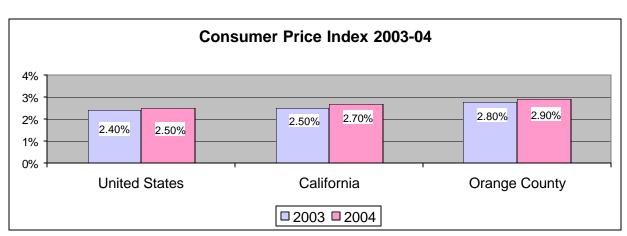
The growth in Real Gross County Product (a measure of the value of goods and services produced in one year and an indicator of the strength of the local economy) is forecasted by Chapman University to increase by 4.69% and reach \$127.2 billion in 2003. This compares to an increase in Gross State Product (for the state of California) of 3.37% and an increase in Gross Domestic Product of 3.81% at the national level during the same time period. Comparisons of Orange County's projected 2003 Gross County Product (GCP) relative to prior years, shows a very slow but steady increase in GCP. For example, GCP in 2000 increased by 6.15%, dropped by 1.19% in 2001; increased by 2.35% in 2002, and is projected to increase by 4.69% in 2003. Orange County's unemployment rate continues to be one of the lowest in the State, and is below that of all surrounding Southern California counties, the state of California and the nation.



Source: Economic & Business Review, Chapman University June 2003

According to Chapman University, Orange County's job growth totaled 1.79% (approximately 24,840 more jobs) in 2001, decreased by 0.75% (approximately 10,667 less jobs) in 2002, and is forecast to increase by 0.98% (approximately 13,805 more jobs) in 2003, and 1.700% (approximately 20,000 more jobs) in 2004.

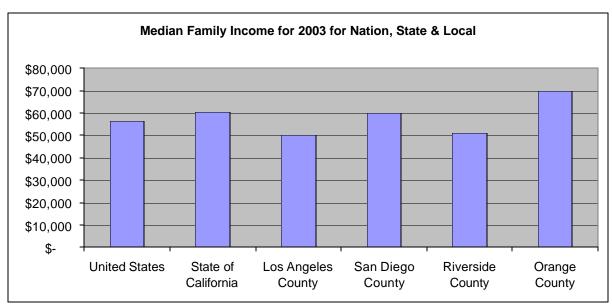
Inflation, as measured by the Consumer Price Index (CPI), is expected to remain moderately low in Orange County, despite being higher than the CPI at the state and national levels in 2003.



Source: Economic & Business Review, Chapman University June 2003

According to DataQuick Information Systems, in July 2003, the median price for new and existing homes in Orange County increased by 18.9% (relative to July 2002), and reached \$428,000. Housing appreciation in Orange County has been rapid in response to the high demand for housing caused, in part, by low interest rates and a tight supply of housing. For the future, Chapman University is projecting that while housing appreciation will slow down, housing affordability (compared to other parts of the country) will continue to remain low.

Median family incomes in 2003 were adjusted ("Re-benched") by the U.S. Department of Housing and Urban Development to correspond with actual data collected during the 2000 Census. Comparisons of adjusted median family income levels in Orange County (based on Chapman University estimates and projections) in 2000, 2001, 2002, and 2003 are \$69,310; \$70,577; \$70,887; and \$72,985, respectively.



Source: Economic & Business Review, Chapman University June 2003

Taxable sales in Orange County are forecasted by Chapman University to increase by 3.2% in 2003 and 4.3% in 2004. This compares to forecast of 2.8% in 2003 and 3.7% in 2004 for the State of California. Taxable sales percentage change estimates and forecast in Orange County for 2000, 2001, 2002, 2003 and 2004 are 10.1%, 0.3%, -1.2%, 3.2%, and 4.3%, respectively.

Water Quality

The County and cities received two new area-wide municipal storm-water permits in January and February of 2002 from the California Regional Water Quality Control Boards covering Orange County. The County is the principal permittee under both permits. The new permits are much stricter and more detailed than previous municipal storm-water permits and also impose significant new requirements. The permittees are required to review new development plans and inspect projects to ensure incorporation of appropriate water quality protection measures (termed best management practices – BMP's), monitor stream, flood control channel and harbor and bay water quality, and report their activities and monitoring results to the Regional Water Quality Control Boards. The permits require new water quality planning initiatives in all thirteen major watersheds in the County, and direct the permittees to cooperate in appropriate regional and watershed water quality management programs. The County and cities must also determine and implement BMP's for public projects, commercial/industrial activities, construction sites, and municipal operations and maintenance activities.

The Public Facilities and Resources Department's (PF&RD) Watershed and Coastal Resources Division administers a management framework, supporting cooperative countywide compliance, comprising committees of permittee representatives to guide the development and implementation of model compliance program elements. In addition, to PF&RD, the Planning and Development Services Department (PDSD) and the Health Care Agency (HCA) also have significant compliance program responsibilities. The cost of municipal permit compliance is substantial, and management is considering a variety of potential funding sources to minimize the impact on the County General Fund.

Long-Term Financial Planning

Strategic Plan: In March 1997, the Orange County Board of Supervisors initiated a financial planning process that is a key component of the County's commitment to fiscal responsibility, accountability and efficiency. As a result, the County has produced six Strategic Financial Plans, the most recent being adopted by the Board on March 4, 2003. The plan includes projections of County general purpose revenues, departmental projections of operating costs, revenues and capital needs for current programs and services and anticipated caseload changes. New programs, services and capital projects are identified and put in priority on a countywide basis to the extent that resources and requirements remain in balance over the next five years. The plan covers a five-year period and includes a ten-year analysis of operating costs in cases where new programs and facilities are recommended to ensure the ability to pay for long-term operational costs. This plan provides the Board with a comprehensive long-term view that serves as a framework in which to fund public services to sustain the well-being of the community. The plan alerts the County to potential financial obstacles on the planning horizon and allows time to proactively plan ways in which to deal with those challenges successfully.

Santa Ana River Mainstem Project: The Santa Ana River Mainstem Project (Project) is a major flood control project, which when fully completed is designed to prevent the type of devastating damage caused by large-scale flooding that can occur on the average of once every 190 years in the Santa Ana River flood plain. The Project involves a combination of flood channel widening and reinforcement, construction of a new dam, Seven Oaks Dam, and raising the existing Prado Dam. The U.S. Army Corps of Engineers (COE) has agreed to designate the Prado Dam feature of the Project as a separate element with a separate implementation and cost share agreement between the COE and the Orange County Flood Control District (OCFCD) only. Upon approval of the new agreement, the OCFCD's funding requirement is guaranteed not to exceed 50% of the costs for the Prado Dam element.

The Federal Government, OCFCD, San Bernardino County Department of Transportation/Flood Control District, and Riverside County Flood Control & Water Conservation District are cost sharing this project based on the COE's estimated total cost of \$1.4 billion. The OCFCD currently estimates its share of costs for the Project to be \$413 million for acquisition of real property rights for construction of the project, relocation of designated roads, bridges, trails, channels and utilities, and construction cost share contributions.

OCFCD's remaining share of the project's costs exceeds current available funds. However, the Project has been authorized by the State Legislature, making it eligible for State Flood Control Subventions (reimbursement of 70% of OCFCD eligible expenditures). An estimated \$10 million is expected to be reimbursed to the OCFCD when funds are available, after audit by the State Department of Water Resources (DWR). Once a claim is reviewed and approved by the DWR, 90% of the eligible expenditures can be paid if funds are available, with the remaining 10% paid after an audit by the State Controller's Office. As of June 30, 2003, the OCFCD has spent an estimated \$217 million on the Project, with resulting claims for estimated reimbursement of \$150 million, which have already been submitted or will be submitted. To date, the OCFCD has submitted \$134 million in claims for reimbursement of eligible expenditures and received \$120 million in reimbursements. The County does not accrue these claim amounts as revenue due to the uncertainty of DWR eligibility approval and due to the typical lengthy review and audit completion time periods after claim submission.

<u>Trial Court Facilities:</u> On September 30, 2002, Governor Gray Davis signed the Trial Court Facilities Act of 2002 (SB 1732). This landmark legislation shifts governance of California's more than 450 courthouse facilities from the counties to the State. The bill took effect on January 1, 2003, however, it is anticipated that the transition time will take up to 7 years. Although no transition date has been set for Orange County, the County has formed a transition task force and negotiating team to develop a plan that will identify the impacts and the steps necessary to ensure a smooth and timely transition. Some important areas under consideration are bonded indebtedness, County department staff within court facilities, deferred maintenance, and capital projects. Once completed, this transfer will cap the County's financial obligation to court facilities to a Maintenance of Effort amount established under the legislation.

Cash Management Policies and Practices

Cash temporarily idle during the year was invested in the Orange County Investment Pools. The Treasurer maintains two separate investment pools, the Orange County Investment Pool (County Pool) and the Orange County Educational Investment Pool (Educational Pool), which is utilized exclusively by the County's school districts. The investment of the County and Educational Pools' is governed by California Government Code and the Treasurer's Investment Policy Statement (IPS). The IPS is submitted annually to the Treasury Oversight Committee and the Board of Supervisors and authorizes investments in the following categories: U.S. Government securities, securities of federally sponsored agencies, domestic commercial paper, negotiable certificates of deposit, repurchase agreements, securities lending agreements, bankers acceptances, money market mutual funds, State of California or California Municipal debt, receivable-backed securities, and medium-term notes. The IPS prohibits borrowing for investment purposes, reverse repurchase agreements, and volatile structured notes and derivatives. Investments are marked to market on a daily basis. If the net asset value of either the County Money Market Fund or the Educational Money Market Fund is less than \$.995 or greater than \$1.005, portfolio holdings may be sold as necessary to maintain the ratio between \$.995 and \$1.005.

The IPS establishes a Money Market Fund and an Extended Fund as components of the County and Educational Pools. The maximum term of any investment under the Extended Fund is three years and the weighted average maturity is limited to 18 months. The maximum term of any investment in the Money Market Fund remains thirteen months with the weighted average maturity limited to 90 days. The Treasurer will determine, based on cash flow projections, the amount of money to invest in the Extended Fund.

In addition to "Pooled Cash/Investments", the Treasurer maintains individual specific investments for certain funds. These amounts comprise a small portion of the total investments managed by the Treasurer. The permitted investments for these funds are dictated by operation of federal or state statute, bond documents, and by mutual agreement with the investing entity.

The County's deposits are either insured by federal depository insurance or are collateralized with securities having a market value of at least 110 percent of the deposits in accordance with Section 53652 of the California Government Code. Collateral of 150 percent is required if a deposit is secured by first mortgages or first trust deeds upon improved residential real property located in California. Portfolio investments, other than money market mutual funds, are held by a third party custodian in the County's name and are classified in the category of lowest custodial credit risk as defined by the Governmental Accounting Standards Board.

In addition, the County held a portion of its Restricted Cash and Investments with Trustee and non-pooled investments in the form of non-participating Bank Investment Contracts (BICs). These BICs are considered deposits with financial institutions and amount to \$13,185 million, of which \$1,511 million is collateralized for non-pooled investment BICs and \$11,570 million is uncollateralized for Restricted Cash and Investment BICs. The collateralized BICs and the uncollateralized BICs are FDIC insured for \$100 thousand and \$100 thousand, respectively.

At June 30, 2003, the weighted average maturity of the County Pool was 153 days and the Educational Pool was 93 days. The average daily investment balance of the County Pool and the Educational Pool amounted to \$2.54 billion and \$1.82 billion, with an average effective yield of 1.78% and 1.54%, respectively, for the fiscal year ended June 30, 2003. The pools managed by the Treasurer have outperformed their designated benchmarks of the 90-day U.S. Treasury Bill and an average of four similar institutional money market funds.

Risk Management

The County has maintained a formal risk management program since the mid 1970's. Risk Management functions include: risk identification, avoidance, prevention, transfer, mitigation and financing programs. Risk financing is achieved through both self-insurance (risk retention) programs and the purchase of commercial insurance. Claims and litigation management also includes subrogation cost recovery activities.

Resources are budgeted in the Workers' Compensation Internal Service Fund and the Property, Casualty and Risk Internal Service Fund. These Internal Service Funds pay program costs including losses, expenses and administration costs. The cash reserves held in these internal services funds are restricted to the payment of current and future costs. Actuarial studies are performed annually to determine the funding requirements for these activities.

Commercial insurance coverage is purchased for the County's property and for certain specialized liability exposures related to airport, helicopter, watercraft, and dam operations. Additionally, fine arts, underground storage tank, boiler and machinery, crime bond policies, notary bonds, and excess insurance for liability are also purchased. All other liability exposures including general, auto and workers' compensation are self-insured. Various risk control techniques, including employee accident prevention training and regular work-site inspections, have been implemented to minimize losses.

AWARDS AND ACKNOWLEDGEMENTS

<u>GFOA Award</u>: The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County of Orange for its CAFR for the fiscal year ended June 30, 2002. The Certificate of Achievement is the highest form of recognition for excellence in state and local government financial reporting.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such a CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

<u>AllM International Best Practices Award:</u> On April 9, 2003, the Association of Information and Imaging Management (AllM) International recognized the County of Orange with a Best Practices award "for successful employment of an imaging, workflow and report management solution to dramatically improve document/records management using Hyland's Onbase technology."

National Association of Counties 2003 Achievements Award Winner: "In recognition of an innovative Electronic Reports Management & Imaging program which contributes to and enhances county government in the United States."

<u>Acknowledgments:</u> I would like to express my sincere appreciation to the staff from my office, other County departments and the staff of the certified public accounting firm of Macias, Gini & Company LLP. I hope this report will be of interest and use to those in County government, other governmental agencies, and the public interested in the financial activity of the County of Orange.

Respectfully submitted,

Original signed by David E. Sundstrom

David E. Sundstrom, CPA Auditor-Controller