



COUNTY OF SANTA CRUZ

AUDITOR-CONTROLLER'S OFFICE

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GARY A. KNUTSON, AUDITOR-CONTROLLER

March 31, 2003

The Honorable Board of Supervisors
County of Santa Cruz
701 Ocean Street
Santa Cruz, CA 95060

Members of the Board and Fellow Citizens:

The Comprehensive Annual Financial Report of the County of Santa Cruz for the fiscal year ended June 30, 2002 is hereby submitted, in accordance with the statutes 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 government. 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 results of operations of the various funds and account groups of the County. All disclosures necessary to enable the reader to gain an understanding of the County's financial activity have been included. These statements have been audited by the independent auditors Vargas and Company, CPAs, who have rendered an unqualified opinion thereon. Their report is provided herein.

The CAFR represents the culmination of all budgeting and accounting activities engaged in by management during the year, covering all funds of the County, its component units and its financial transactions. The CAFR is organized into four sections: introductory, financial, statistical and glossary.

- The Introductory Section is intended to familiarize the reader with the organizational structure of the County, the nature and scope of the services it provides, and the specifics of its legal operating environment. The introductory section includes this transmittal letter, the County's organizational chart and a list of elected and appointed officials.
- The Financial Section includes the audited basic financial statements, disclosure notes, required supplementary information, supporting statements and schedules necessary to fairly present financial position and the results of operations of the County in conformity with generally accepted accounting principles, and the independent auditor's report on the basic financial statements. New this year is the narrative introduction, overview and analysis found in management's discussion and analysis (MD&A).
- The Statistical Section contains comprehensive statistical data on the County's financial, physical, economic, social and political characteristics. The statistical section includes selected financial and demographic information, generally presented on a

multi-year basis.

- The Glossary Section provides definitions of the various specialized terms used in this document.

The County is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984 and U.S. Office of Management and Budget Circular A-133, Audits of State and Local Governments. Information related to this single audit, including the schedule of federal financial assistance, findings and recommendations, and auditor's reports on the internal control structure and compliance with applicable laws and regulations, are included in the single audit report, which is issued as a separate document. This report includes all funds and account groups of the County. The County provides the full range of services contemplated by statute or ordinance. These services include public protection, public ways and facilities, health and sanitation, public assistance, recreation and culture, education, and general government. In addition, various utility, maintenance, redevelopment and capital acquisition entities are included as part of the reporting entity based on financial accountability. School districts and autonomous special districts have not met the established criteria for inclusion in the reporting entity, and are therefore reported under the category of fiduciary fund types.

Santa Cruz County was established by an act of the State Legislature in 1850 as one of the original 27 counties of the State of California. The County is a general law county and is governed by a five-member Board of Supervisors who are elected by district to serve alternating four year terms. The Board of Supervisors uses the appointed County Administrative Officer (Chief Executive) organizational structure to carry out its policies as set forth by County Ordinance. The Assessor, Auditor-Controller, County Clerk/Treasurer Tax-Collector, District Attorney and Sheriff are elected officials while all other departments are headed by appointed officials. The Superior and Municipal Courts, which are only financed in part by the County budget, are headed by ten elected judges and are now a State Agency rather than a County Department.

As required by County Ordinance or by State or Federal law, the County's principal functions include seven major areas: general government, public protection, public ways and facilities, health and sanitation, public assistance, education and recreation and cultural services. In the public assistance and health areas, the State and Federal governments mandate certain minimum levels of service.

Santa Cruz is the second smallest county in California in terms of land mass and the 23rd of 58 in terms of population. The County is located on the Central Coast of California adjacent to the economic prosperity of California's Silicon Valley. Santa Cruz County is surrounded by San Mateo County to the north, Santa Clara County to the east, San Benito and Monterey Counties to the South and the newly created Monterey Bay National Marine Sanctuary to the West.

FINANCIAL INFORMATION

Management of the County is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the County are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) The cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

In accordance with the County Budget Act codified in the Government Code, the County prepares and adopts a budget on or before October 2 for each fiscal year. Budgets are adopted for the General Fund and Special Revenue Funds. In addition to the controls mentioned above, the County maintains budgetary controls, whose objective is to ensure compliance with legal provisions embodied in the annual appropriated budget. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is at the character level of salaries and benefits, services and supplies for each budget unit within each budgeted fund. Other charges, land, plant and improvements, and equipment are controlled on a line item basis within each budget unit. The County also maintains an encumbrance accounting system as one technique for accomplishing budgetary control. At year-end encumbrances lapse, but are generally reappropriated as part of the following year's budget. The encumbrance system is employed to record amounts committed for purchase orders or contracts. If appropriations are not sufficient, Board of Supervisors-approved appropriation transfers are required before commitments or expenditures are permitted. Encumbrances outstanding at year-end are shown as reservations of fund balance, except for grant encumbrances which are canceled at year-end and rebudgeted in the new fiscal year along with associated revenues.

ECONOMIC CONDITIONS AND OUTLOOK

The County's financial position ended lower than the prior fiscal year, but overall it is still a solid financial position with \$15 million designated or undesignated in various accounts. Meanwhile the general economy, with exceptions for automobile sales and recording fees due to home mortgage refinancings, is in various stages of recession like the rest of the country. Due to these changes in the economy, the County reduced its revenue estimates for sales taxes, transient occupancy tax and deed transfer taxes from the 2001-2002 budget. In addition to the downturn in the general economy, a ballot measure in March 2002 resulted in the repeal of the Utility Users Tax. As a result, the County lost about \$3 million in the 2001-02 fiscal year and made reductions of about \$9 million of lost on-going general purpose revenues and budget spending reductions to offset most of the loss. Beyond these fiscal issues, the State of California is projecting a \$35 billion deficit and has required mid-year revenue reductions of \$4.6 million, and a \$6.3 million reduction in budgeted spending in the current fiscal year. The State's financial crisis could have monumental impacts on programs in the 2003-04 fiscal year with the possible loss of the Motor Vehicle in Lieu Tax backfill of about \$12 million. In addition, the State has issued IOU's (accounts receivable) for its responsibility to reimburse counties for State Mandated Programs and the related costs. For the 2001-02 and estimated 2002-03 fiscal year, \$2.2 million is the estimated amount and the county has established a reserve in an equal amount to offset the accounts receivables accrued at year-end due to the uncertainty of the State paying those amounts in the future. It seems inconceivable that the State would not look to sharing its fiscal burdens with counties, cities, and local agencies consistent with its history of revenue shifts and changes in local program responsibilities and loss of adequate funding to fulfill these mandates.

MAJOR INITIATIVES

During the past fiscal year, the following major initiatives included:

- A General Fund contribution of \$5 million to the Road Fund to improve the county road system. The 2002-2003 budget provides \$1 million to continue this effort.
- A program to complete a number of important deferred maintenance projects at different county facilities.

- The County prepared a request for proposals to invite interested providers of ambulance services. Presently, the County is working out the terms and conditions with the low and most responsible bidder.
- The Probation Department continues its focus on juvenile justice issues, including Restorative Justice programs, attention to minority over-representation, and strenuous efforts to control the population of Juvenile Hall. Through these efforts, the average population in Juvenile Hall for 2001-02 has been 34, a 29% reduction since 1999-00. The expanded remodeling of the Juvenile Hall will continue in 2003-04 to improve the safety, security, and programs at the facility.
- AB 1913, the Crime Prevention Act of 2000, allocates \$900,650 to Santa Cruz County to fill gaps in the existing juvenile justice continuum, respond to community concerns and identified needs, provide proven treatment services, and build community capacity to address delinquency. The Probation Department's plan builds upon family resource centers to provide community and neighborhood interventions and services. In addition, AB 1913 funds will be used to enable the Probation Department and Mental Health to provide a short-term residential treatment option for youth in the juvenile justice system struggling with substance abuse and multiple risk factors.
- The Sheriff received significant additional resources to implement a mobile data computing system which will increase the efficiency and effectiveness of the department and additional internal support staff to assist with technological improvements throughout the department.
- The County provided for several building maintenance projects designed to address the physical infrastructure needs of the County's detention facilities, including the development of a Work Release Facility to relieve crowding and improve safety in the main jail lobby area and also continues support for the Sheriff's efforts to transition to the direct supervision mode in the Main Jail upon completion of security upgrades.
- Completed successful Special District Elections in November 2001 and the Gubernatorial Primary Election in March 2002. The elections database was updated with the new reapportioned legislative boundaries and redistricted supervisorial and local district boundaries. The current elections computer system was upgraded to integrate the ballot counting system, the candidate system, and the voter file into one seamless point and click environment. The Windows environment allows elections information and results to be published directly to the web.
- The Auditor-Controller's office and the Information Services Department evaluated web-based credit card payment processes. First implementation is planned to be completed in the Treasurer Tax-Collector's office by Spring.
- Calendar Year 2001 is the sixth consecutive year that the County has qualified for the State-County property tax administration loan program funds in the amount of \$565,000. This has enabled the Assessor, Treasurer Tax-Collector, Auditor, and Clerk of the Board to accomplish the work specified in the County's approved plan.
- The Personnel Department has enacted requirements to address labor/management

disputes through the Personnel Employee Relations Board, to process county-wide internet recruitment, and to assist with specialized, hard to recruit positions.

- The Information Services Department is engaged in a full range of technology improvement projects. These include the evaluation of a new audio recording and archive system for the Clerk of the Board, the development of an on-line job application management and routing system, and modifications of the land use system to a PC client system with web interface. Projects for 2001-02 included providing continued leadership in electronic document management and imaging technologies for County departments and the conversion of all fire district "run books" to a common electronic format.
- The allocation of funds for various capital projects and facility upgrades which address energy conservation, health and safety related repairs, access modifications, and deferred maintenance activities. The program includes renovation and maintenance of the public health clinics, County adult and juvenile detention facilities, veteran's facility upgrades in Santa Cruz and Watsonville, additional funding for the replacement of the modular court buildings, parks facility upgrades and youth recreation improvements.
- Clinic services are continuing to work on vital infrastructure needs including the public health laboratory, data systems, and clinic space remodeling. Detention Health Services has been restructured to provide additional leadership resources in the Jail, Juvenile Hall, and Roundtree facilities.
- Proposition 36 requires the County to provide drug treatment services to any person convicted of a nonviolent drug possession offense. The Health Services Agency and criminal justice departments are developing a program to address this new mandate, which became effective July 1, 2001.
- The County Administrative Office continues to coordinate the implementation of the County's Integrated Pest Management Policy. Technical support is provided under contract by the University of California Cooperative Extension, and all departments with pest control responsibilities are actively participating. County departments have made significant and commendable progress in the reduction of quantities and risk levels of pesticides used on County property, and further progress is anticipated next year.
- The Agricultural Commissioner is conducting a vigorous program to prevent the introduction of the glassy-winged sharpshooter into the County and to develop effective and appropriate response plans should the sharpshooter be detected.

OTHER INFORMATION

Independent Audit – State statutes require an annual audit by independent Certified Public Accountants. The firm of Vargas and Company, CPAs was selected to audit the financial statements of the County's various funds and account groups, and has issued a qualified opinion thereon. In addition to meeting the requirements of state law, the audit was also designed to comply with the federal Single Audit Act of 1984, and related OMB Circular A-128. The auditors' report on the financial statements is included in the financial section of this report. The auditors' reports

related specifically to the single audit are included in a separate Single Audit Report.

Awards - The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County of Santa Cruz for its comprehensive annual financial report for the fiscal year ended June 30, 2001. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. Such 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 conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

The California State Controller presented an Award for Achieving Excellence in Financial Reporting for the fiscal year ended June 30, 2001. This award is presented for achieving the highest quality in California government accounting and financial reporting.

AUDITOR-CONTROLLER ACKNOWLEDGMENTS

I wish to express my appreciation to my Accounting and Audit Divisions, the County departments which participated, and Vargas and Company, CPAs, for their contributions, assistance, and guidance in the preparation of this report.

Respectfully submitted,


Gary A. Knutson
Auditor-Controller