



COUNTY OF SANTA CRUZ

AUDITOR-CONTROLLER'S OFFICE

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December 17, 1999

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, 1999, 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 Grand Jury's independent auditors Vargas, Lopez and Company CPAs, who have rendered a qualified opinion thereon. Their report is replicated on page 3.

The comprehensive annual financial report is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, the County's organizational chart and a list of principal officials. The financial section includes the general purpose financial statements and the combining and individual fund and account group financial statements and schedules, as well as the auditor's report on the financial statements and schedules. The statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

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 in 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.

ECONOMIC CONDITIONS AND OUTLOOK

California counties are political subdivisions of the State of California and are not financially independent. The General Fund's principal revenue sources are the State and federal government which provide more than 50 percent of the financial resources.

During the 1998-99 fiscal period, the County has not only benefitted from the strong national, state, and local economies but new State and federal initiatives have also resulted in reduced welfare caseloads, reduced demand for food stamps, lower cost of financing local courts, and increases in new law enforcement staff. As a result, the General Fund ended the year stronger than the prior year.

The 1999-00 fiscal year budget is predicated upon a continued strong economy and more financial assistance from the State of California. The State Budget provided financial relief in the form of Educational Revenue Augmentation Fund Subvention (ERAF) based upon population and County's financial contribution to the ERAF estimated to total about \$630,000. In addition, the County's trial court funding obligation decreased from \$6.6 million to \$2.1 million. Beyond this the County anticipates receiving a first installment from the Tobacco Industry Settlement in the amount of \$1 million. As a result, the County was able to strengthen its general contingency reserve balance from \$1.8 million to \$3.5 million and was able to provide for major capital improvements including those to the juvenile hall and planning for the replacement of the modular court buildings. Additionally, the County's employee retirement contribution rates dropped significantly providing

funding for the newly negotiated labor contracts that now cover a new three year period commencing in November 1999.

The County is a defendant in two separate litigations involving the Pajaro River Flood and a challenge of the Utility Users Tax. The outcome of these cases and the financial impacts are presently unknown, and it is doubtful that they will be settled any time in the near future. We have received estimates from the U.S. Army Corps of Engineers that the cost of replacing the Pajaro River levies would be about \$60 to \$70 million. The County is working on obtaining federal and state aid to finance most of these estimated costs, however, the County's share is still likely to be significant.

MAJOR INITIATIVES

The County has successfully completed most of its new projects while carrying out its normal goals and objectives. During 1998-99 the following major projects were completed or near completion:

- ninety six percent of all information systems have been made year 2000 compliant with the remaining initiatives planned to be completed before the end of the calendar year.
- accomplished the deployment of sheriff deputies to community service centers throughout the unincorporated areas of the county.
- opened a branch office of the Planning Department in Felton with plans to open another branch in the south county area.
- installed a new replacement collection system for delinquent unsecured tax and departmental revenues in the County Treasurer/Tax Collector's Office.
- opened a major new recreation facility, the Simpkins Family Swim Center in Mid-County.
- completed the network of three one stop career centers in North, Mid and South County to assist the transition of welfare recipients and others to the workforce and to serve businesses seeking qualified workers.

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 August 30, 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.

The remainder of this section discusses financial activities for the fiscal year 1998-99.

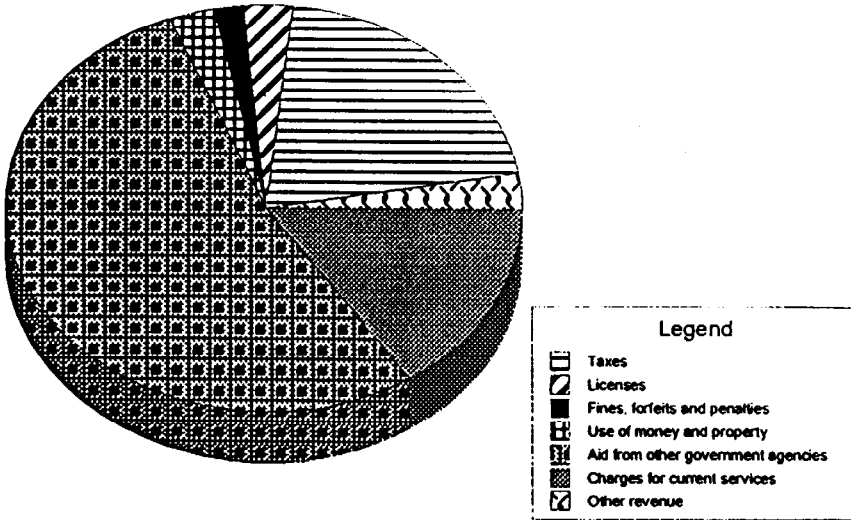
General Government Functions - The general fund is used to account for all the activities of a general nature including administration, legislation, public protection, health and welfare, parks and recreation.

The following schedule presents a summary of general fund revenues for the year ended June 30, 1999, and the amount and increases and decreases in relation to the prior year.

REVENUES

	<u>1998-99</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Revenues:			
Taxes	\$ 41,116,054	\$ 1,357,795	3.42%
Licenses	6,936,922	922,862	15.35%
Fines, forfeits and penalties	4,503,921	874,152	24.08%
Use of money and property	5,551,429	413,418	8.05%
Aid from other government agencies	111,878,656	9,637,300	9.43%
Charges for current services	30,583,335	658,956	2.20%
Other revenue	<u>3,600,749</u>	<u>(1,308,584)</u>	<u>-26.66%</u>
Total revenues	\$ <u>204,171,066</u>	\$ <u>12,555,899</u>	<u>6.55%</u>

General Fund Revenues by Source



General fund revenues for 1998-99 totaled \$204,171,066 a 6.55% increase from the previous year. The most significant revenue changes resulted from the following:

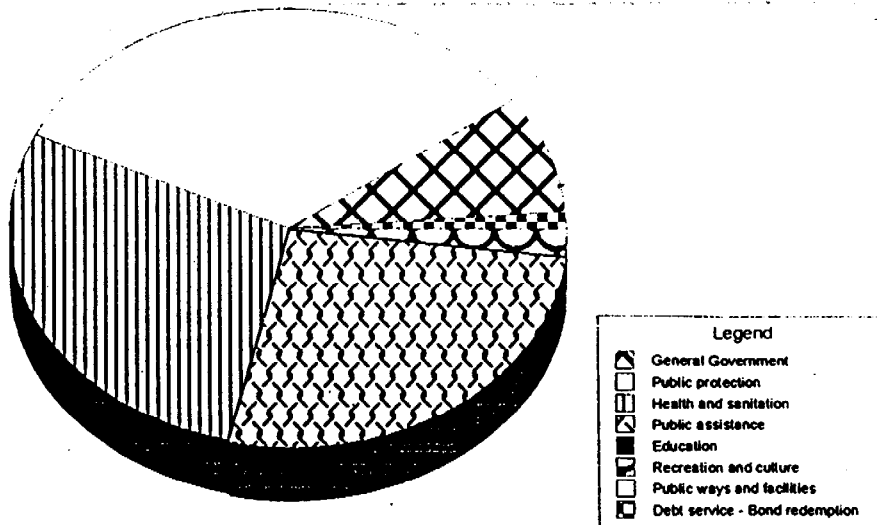
- \$0.6 million increase due to issuance of more building permits.
- \$0.8 million increase due to change in fine distributions based upon a full year.
- \$0.4 million increase due to issuance of a 15 month Tax and Revenue Anticipation Note and improved cash balance.
- Aid from Other governmental agencies is as follows:
 - a. Increase of one million attributable to motor vehicle in lien tax
 - b. Increase five million in State and Federal aid due to welfare reform.
 - c. Increase of two million in State and Federal Health assistance payments.
- decrease of one million in other revenue due to interfund charges for reimbursement related to issuance of debt.

The following schedule summarizes general fund expenditures for 1998-99, and increases and decreases from 1997-98.

EXPENDITURES

	<u>1998-99</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Expenditures:			
Current:			
General government	\$ 17,752,224	\$ 504,914	2.93%
Public protection	69,585,922	3,338,902	5.04%
Health and sanitation	56,859,767	680,676	1.21%
Public assistance	57,469,389	4,334,075	8.16%
Education	84,966	(312)	-0.37%
Recreation and culture	4,376,025	526,029	13.66%
Public ways and facilities	119,946	(8,116)	-6.34%
Debt service - Bond redemption	<u>2,105,598</u>	<u>(175,236)</u>	<u>-7.68%</u>
Total expenditures	\$ <u>208,353,837</u>	\$ <u>9,200,932</u>	<u>4.62%</u>

General Fund Expenditures by Function



Total general fund expenditures for 1998-99 totaled \$208,353,837, a 4.62% increase from 1997-98. The most significant increases and decreases in expenditures occurred in the following areas:

- increase in public assistance is due to the new welfare to work program.
- increase in Recreation and Culture reflects the restoration of Parks funding that was cut with the effects of Proposition 218 and the prior recession.

General Fund Balance - The unreserved, undesignated fund balance of the General Fund increased by \$1,250,591 as the net result of operations. The fund balance available of \$6,471,683 represents financial resources available at June 30, 1999 to finance expenditures for the fiscal year 1999-2000.

Proprietary Operations - Proprietary funds are used to account for internal service and enterprise activities.

Internal service funds include the County's motor vehicle fleet, information services and public works. The intent is for these functions to operate on a cost recovery basis and provide funds for the replacement of assets. Any operating deficits will be recovered through increased charges in subsequent years.

Enterprise funds consist principally of water and sanitation districts under the Board of Supervisors. These are funded by user charges and any deficiencies as a result of operations are made up through rate increases in the following year.

Fiduciary Operations - The County maintains a significant number of funds to carry-out its fiduciary responsibilities. These include funds for school districts, autonomous special districts, payroll and taxes.

Debt Administration - The County has entered into lease-purchase agreements with the Santa Cruz County Public Financing Authority. These lease-purchase acquisitions have been financed by Certificates of Participation issued which have varying maturity dates through the year 2026. These issues have been rated BBA1 and A1 by Moody's. While the County's obligation is a lease-purchase, as stated, the total amount of the Certificates obligation of \$55.0 million has been included in the County's long-term debt for reporting purposes.

Cash Management - Cash is pooled for the purpose of increasing interest income through investment activities. Investments are stated at cost plus accrued interest, which approximates market value. Investments consist of United States Treasury bills, United States Treasury notes, bankers' acceptances, commercial paper, negotiable and time certificates of deposit, and other investments authorized by Government Code Section 53635. At June 30, 1999, cash and investments totaled approximately \$429.6 million.

During the fiscal year, \$18 million was earned from the investment of all idle funds on deposit in the treasury. This was an increase from the prior year which totaled \$15.2 million.

Risk Management - The County is self-insured for liability, workers compensation, and some employee dental care. The County purchases insurance for other risks including liability and property, long term disability, health, and dental for public safety employees. Resources are accumulated in the Self-Insurance Fund to meet potential future losses. The County's Risk Management Division implements various risk control techniques, and loss prevention and reduction programs, including employee training and education, as part of the comprehensive risk management plan.

OTHER INFORMATION

Independent Audit - State statutes require an annual audit by independent Certified Public Accountants. The firm of Vargas, Lopez 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 general purpose 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, 1998. 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, 1998. 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 the Grand Jury Auditors, Vargas, Lopez and Company, CPAs, for their contributions, assistance, and guidance in the preparation of this report.

Respectfully submitted,


GARY A. KNUTSON
Auditor-Controller