



COUNTY OF SANTA CRUZ

AUDITOR-CONTROLLER'S OFFICE

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GARY A. KNUTSON, AUDITOR-CONTROLLER

December 17, 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, 2003 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-including the management discussions and analysis, 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.

- 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 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 re-appropriated 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 grants. Grant encumbrances are canceled at year-end and re-budgeted with revenues in the new fiscal year.

ECONOMIC CONDITIONS AND OUTLOOK

The County of Santa Cruz, albeit for the State of California's financial crisis, would be able to plan its way through its own budget difficulties caused by raising labor costs and revenue imbalances due to the pressures of a weak regional economy. In the 2001-02 fiscal year, the county made budget reductions to offset the repeal of the \$9.7 million Utility Users Tax. In the current 2002-03 fiscal year, the county made additional budget reductions totaling \$4.5 million to offset the raising cost of labor contracts and a continued weak regional economy. Due to the State of California's financial crisis, the County's General Fund has loaned it \$2.9 million for unpaid State Mandated Programs and another \$4 million for the backfill of the Motor Vehicle in Lieu Tax. The State has promised to repay the \$4 million by the 15th of August 2006, and has given no indication when the \$3.6 million will be repaid. As a result, the General Fund's reserves were reduced accordingly. Due to the uncertainty of the repayment of the State Mandated Programs, these amounts have been written off as likely uncollectible.

Consequently, we believe it is not possible to comment on prospects for the future until the State of California determines just how it will address the future with a \$30-\$38 billion carry-over deficit and the impact of the repeal of 66% of the Motor Vehicle in Lieu Tax which counties and cities depend upon for general government programs. If the State of

California fails to make everyone whole, the County of Santa Cruz could lose up to \$12 million this year and \$11.5 million on-going revenues

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 \$1 million to the Road Fund to improve the county road system. Since 2000-2001, the General Fund has allotted a total of \$13 million towards the road payment program.
- A program to complete a number of important deferred maintenance projects at different county facilities.
- The County completed a request for proposals to invite interested providers of ambulance services. Recently, the County awarded the contract to American Medical Response West (ARMW) for ambulance services.
- Completed successful Special Recall Election in November 2003
- The Auditor-Controller's office and the Information Services Department evaluated web-based credit card payment processes. First implementation was completed in the Treasurer Tax-Collector's office.
- The County's Local Area Network (LAN) and Wide Area Network (WAN) infrastructure has been upgraded and is ready for applications requiring high bandwidth for web and multimedia use.
- 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 have implemented a program.
- A new Joint Powers Authority was created to provide animal patrol and shelter services for the County, City of Santa Cruz, City of Capitola, and City of Scotts Valley.

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 an unqualified 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-133. 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.

Award - 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, 2002. 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.

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