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COUNTY OF ORANGE**

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December 2, 2005

The Citizens of Orange County:

The Comprehensive Annual Financial Report (CAFR) of the County of Orange, State of California (County), for the fiscal year ended June 30, 2005, is hereby submitted in accordance with the provisions of Sections 25250 and 25253 of the Government Code of the State of California. The report contains financial statements that have been prepared in conformity with United States generally accepted accounting principles prescribed for governmental entities. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the County. A comprehensive framework of internal controls has been designed and established to provide reasonable assurance that 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. Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute assurance that the financial statements will be free from material misstatements.

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 for the fiscal year ended June 30, 2005, are free of material misstatement. The independent certified public accounting firm has issued an unqualified ("clean") opinion on the County's financial statements as of and for the fiscal year ended June 30, 2005. The independent auditor's report is located at the front of the financial section of this report.

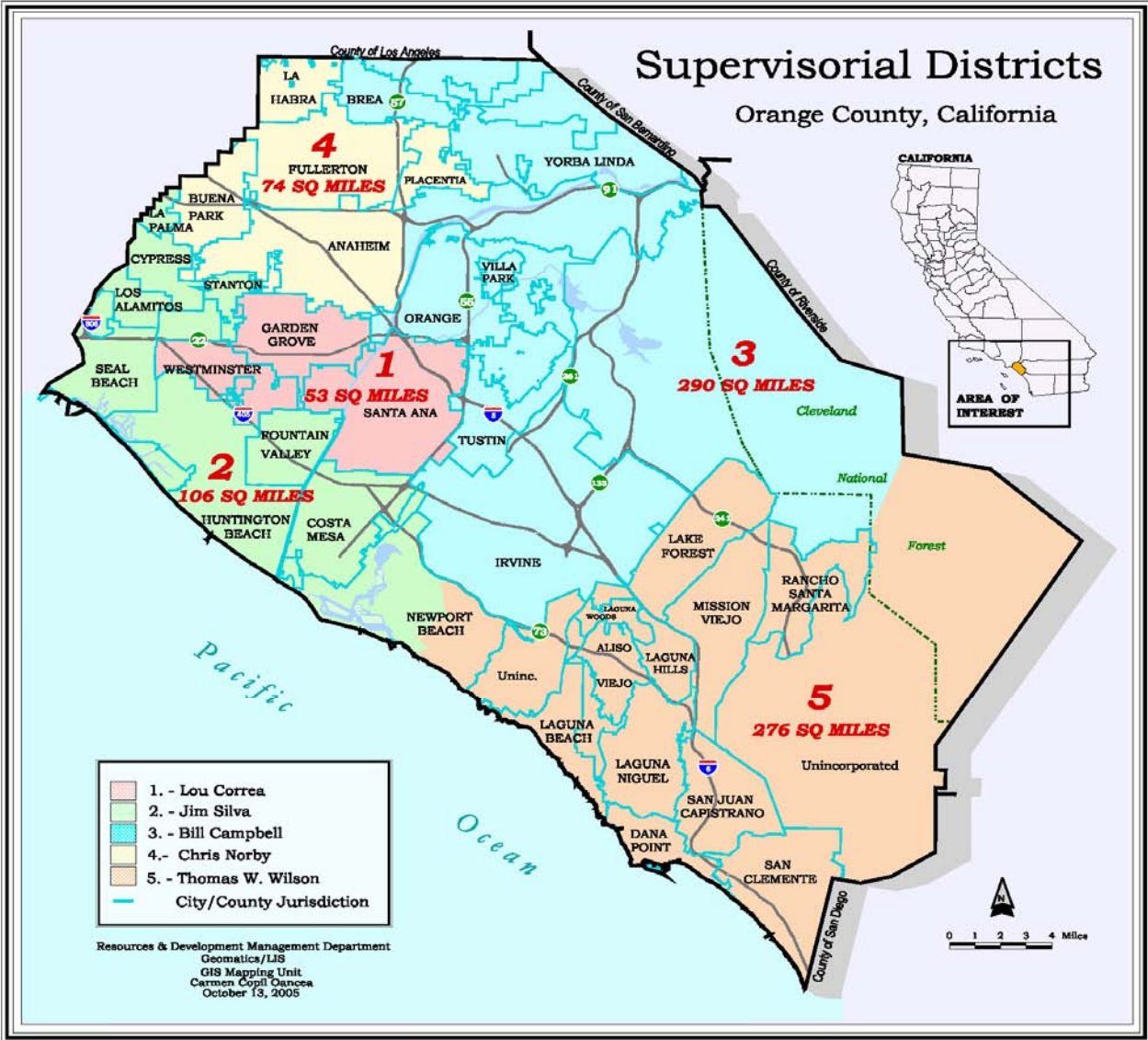
This letter of transmittal is designed to complement and should be read in conjunction with Management's Discussion and Analysis (MD&A) that immediately follows the independent auditor's report. MD&A provides a narrative introduction, overview, and an analysis of the basic financial statements.

**PROFILE OF THE GOVERNMENT**

The County, 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. The 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 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 24 County Departments, seven of which have elected department heads. The Supervisorial Districts map below 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:

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

<b>Unincorporated Area Services</b>	
Animal Control	Libraries
Flood Control	Parks
Land Use	Water Disposal Collection
Law Enforcement	

<b>Contract Services for Cities</b>	
Animal Control	Libraries
Law Enforcement	Public Works & Engineering

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 Children and Families Commission of Orange County (CFCOC), 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, 2005: 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, In-Home Supportive Services Public Authority, 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, Capital Projects and Permanent 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 is part of the Basic Financial Statements. The Refunding Bonds & Recovery Certificates of Participation and Debt Prepayment Fund and the Nonmajor Governmental Funds with appropriated annual budgets comparisons are presented in the Supplementary Information section 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.ocgov.com> provides extensive information about County government and its services to the citizens of Orange County and others who visit our web pages. Approximately 419,000 visits are made to the Orange County web site each month and those visitors view over 1.9 million pages of information. The County's website includes information about the Board of Supervisors, e-mail to Board offices, Board Agendas, County job listings, purchasing bid solicitations, County directories, 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 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, ordering birth, death and marriage certificates, 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.

**FACTORS AFFECTING ECONOMIC CONDITION**

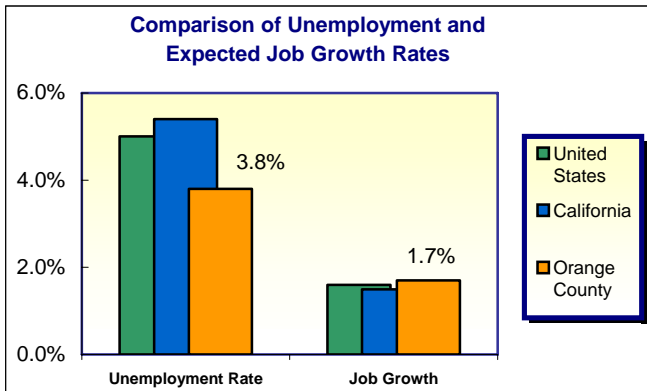
**Local Economy**

Two indicators of Orange County economy are: 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). This section provides various external and internal indicators that describe the current and projected outlook of the Orange County economy.

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 world's countries. Current external indicators show that conditions in Orange County remain relatively favorable when compared to surrounding counties, the state and the nation.

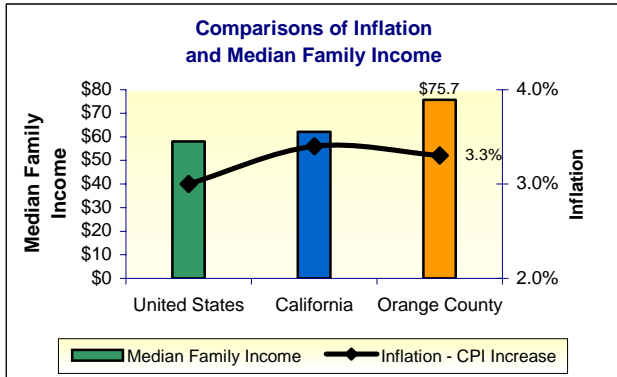
Orange County's unemployment rate continues to be one of the lowest in the State and is below that of all surrounding Southern California counties, the State of California, and the nation (see Table 1).

<b>Table 1 : Unemployment Rate Comparison</b>	
Primary Government Entity	August 2005 Unemployment Rate
United States	4.9%
California	5.2%
Los Angeles County	5.0%
<b>Orange County</b>	<b>3.8%</b>
Riverside County	5.6%
San Bernardino County	5.1%
San Diego County	4.3%



In addition, according to Chapman University, Orange County's job growth is expected to increase by 1.7% in 2005, resulting in 24,286 more jobs relative to 2004. This compares favorably, in percentage growth, with the State of California at 1.5% and the national level at 1.6% during the same time period.

Sources: State of California, Employment Development Department  
Economic & Business Review, Chapman University, June 2005



Sources: Economic & Business Review, Chapman University, June 2005  
 U.S. Department of Housing and Urban Development, 2005

Inflation, as measured by the Consumer Price Index (CPI), is expected to remain moderately low in Orange County and to be slightly higher than the CPI at the national level in 2006. Chapman University projects an increase of the CPI at the national level, state level, and county level as stated in Table 2.

United States	California	Orange County
3.0%	3.4%	3.3%

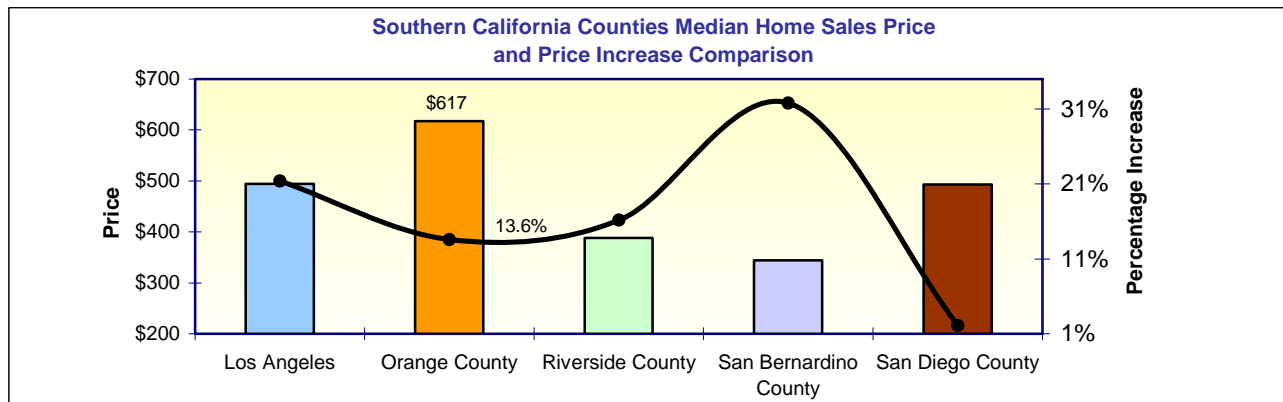
Median family incomes were adjusted (“re-benched”) in 2003 by the U.S. Department of Housing and Urban Development (HUD) to comply with actual data collected during the 2000 Census. Orange County’s adjusted HUD median family income is expected to be \$75,700 absolute dollars in 2005. Refer to Table 3 for comparison to other primary government entities.

Primary Government Entity	Median Family Income (absolute dollars)
United States	\$58,000
California	\$62,100
Los Angeles County	\$54,450
<b>Orange County</b>	<b>\$75,700</b>
Riverside County	\$55,650
San Diego County	\$63,400

According to DataQuick Information Systems, in August 2005, the median home sales price for new and existing homes in Orange County increased by 13.6% (relative to August 2004) and reached \$617,000 (absolute dollars). Compared to the surrounding counties, the increase in Orange County was not the highest (refer to Table 4). Annual housing appreciation in Orange County, although not as great as in surrounding Southern California counties, has continued to increase at a relatively rapid rate. Moreover, the median sales price in Orange County continues to exceed all surrounding Counties by a substantial amount (refer to Table 4).

Primary Government Entity	Median Home Sales Price Increase (%)	Median Home Sales Price (absolute dollars)
Los Angeles	21.4%	\$494,000
<b>Orange County</b>	<b>13.6%</b>	<b>\$617,000</b>
Riverside County	16.2%	\$388,000
San Bernardino County	31.8%	\$344,000
San Diego County	2.1%	\$493,000

For the future, Chapman University is projecting that housing appreciation will decrease sharply and housing affordability (compared to other parts of the country) will continue to remain low.



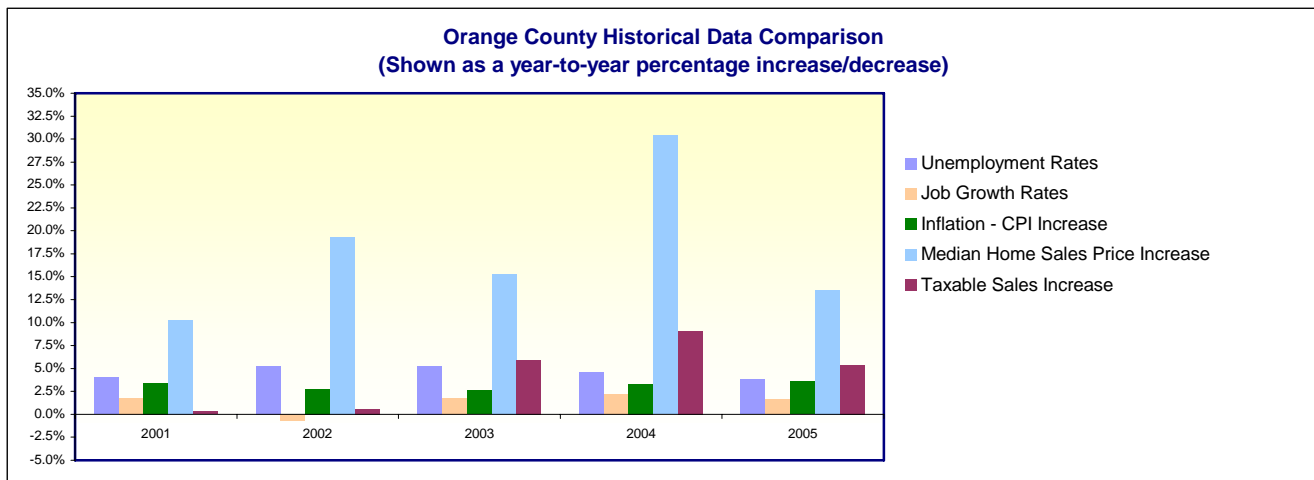
Source: DataQuick Information Systems, August 2005



In terms of internal trends, current and projected indicators suggest that the Orange County economy will continue to grow at a slow but steady pace in 2005 and 2006. Comparisons of Orange County's unemployment rates from January 2005 through June 2005 were consistently favorable. Historical point-in-time unemployment rates in Orange County during the month of June of 2001 to 2005 show favorable recent trends. Job growth in Orange County has been steadily recovering from 2001 to 2005 (refer to Table 5). The projected job growth in Orange County is 1.2% in 2006. Comparisons of Orange County's historical CPI trends from 2001 to 2005, again, are relatively favorable. It is projected to be 3.3% in 2006 by Chapman University. Year-to-year home sales price increases in Orange County for the month of June from 2001 to 2005 indicate housing affordability will continue to remain low. Taxable sales in Orange County continually increased from 2001 to 2005. It is expected to increase 4.6% in 2006 as forecasted by Chapman University. This compares to an increase of 4.3% for the State of California.

**Table 5: Orange County Historical Data**

Historical Indicators	2001	2002	2003	2004	2005
Unemployment Rates	4.0%	5.3%	5.3%	4.6%	3.8%
Job Growth Rates	1.8%	-0.7%	1.8%	2.2%	1.7%
Inflation-CPI Increase	3.4%	2.8%	2.6%	3.3%	3.6%
Median Home Sales Price Increase	10.3%	19.3%	15.3%	30.4%	13.6%
Taxable Sales Increase	0.3%	0.6%	5.9%	9.1%	5.4%



Sources: State of California, Employment Development Department  
Economic & Business Review, Chapman University, June 2005  
DataQuick Information Systems, August 2005

In summary, overall economic growth in Orange County continues to look favorable relative to surrounding counties, the State, and the nation. Moreover, projected trends suggest that the growth of the local economy will be slow but steady during the balance of 2005 and throughout 2006. Chapman University issues economic forecasts twice each year in their Chapman Economic and Business Review; the next forecasts will be issued on December 8, 2005.

**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 annual Strategic Financial Plans, the most recent being adopted by the Board on April 12, 2005. 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 prioritized 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 develop strategies to successfully address those challenges.

Early Debt Payment Plan: In August 2005, the County successfully completed a refunding and restructuring of the \$763,200 of bankruptcy related debt. The County utilized \$116,200 accumulated in the Debt Prepayment Fund to defease the non-callable portions of the bankruptcy debt and refund the remaining principal. Additionally, the debt term will be shortened by approximately 10 years for the 1996 Recovery Certificates of participation (COPS) from the year 2026 to the year 2016 at which point all of the bankruptcy debt would be paid. More information on the bankruptcy debt refinancing is available in Note 19, Subsequent Events.

Santa Ana River Mainstem Project: The Santa Ana River Mainstem Project (SARP) was initiated in 1964, in partial response to a resolution of the United States House Committee on Public Works adopted May 8, 1964. A survey report was completed by the Orange County Flood Control District in 1975. The report was reviewed and submitted to Congress in September 1978. In September 1980, the United States Corps of Engineers completed the General Design Memorandum for the SARP. Construction of the SARP was authorized by the Water Resources Development Act of 1986. Construction of SARP was initiated in 1989, and completion is scheduled for 2010.

The SARP is designed to provide flood protection to the growing urban communities in Orange, Riverside and San Bernardino Counties. The proposed improvements to the system cover 75 miles, from the headwater of the Santa Ana River east of the city of San Bernardino to the mouth of the river at the Pacific Ocean between the cities of Newport Beach and Huntington Beach. The project will increase levels of flood protection to more than 3.35 million people within the three county areas. The project includes seven independent features: Seven Oaks Dam, Mill Creek Levee, San Timoteo Creek, Oak Street Drain, Prado Dam, Santiago Creek and the Lower Santa Ana River. More information on the SARP is available in Note 14, Construction and Other Significant Commitments.

Trial Court Facilities: 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.

On May 4, 2004, the Board of Supervisors received the "County of Orange South Court Facility Program" and "County of Orange South Court Facility Master Plan" reports. The program option selected for further review and planning is for a 206,000 square foot courthouse to include 14 new courtrooms and the reuse of 4 existing courtrooms (18 total courtrooms). The project cost for the courtrooms and a parking structure are estimated to cost approximately \$118,000. Presently, staff of the County, Superior Court and the State Administrative Office of the Courts (AOC) are researching options for financing and construction of the project.

It is anticipated that the County's total funding commitment for South Court will not exceed \$29,400. The Strategic Financial Plan proposed a 30-year financing of the County's contribution. Since the financing options are under review, this proposal is subject to future change.

The August 2005 refunding of the 1996 Recovery Certificates of Participation allowed the County to unencumber (release) all court properties from this particular refunding debt. The current South Court facility was released in March 2003. The Betty Lou Lamoreaux Justice Center continues to be encumbered by the Orange County Public Financing Authority, Juvenile Justice Center Facility Lease Revenue Refunding Bonds, Series 2002 and is the only remaining court facility with bonded indebtedness.

## **Relevant Financial Policies**

Cash Management Policies and Procedures: 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). California Government Code and the Treasurer's Investment Policy Statement (IPS) govern the investment of the County and Educational Pools.

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

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. More information is available in Note 3, Deposits and Investments.

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 and Casualty 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 retained for 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 established to minimize losses.

## **Major Initiatives**

Water Quality: The County and cities received two new area-wide municipal stormwater 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 collaborative 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.



Because of the importance of beach recreation to Orange County's economy and quality of life, the County and cities are investing heavily in runoff reduction and treatment programs. At the same time, the County is leading a regional coalition to review and update the water quality standards that are used to determine whether beaches and streams are unsafe because of pollution.

#### **AWARDS AND ACKNOWLEDGEMENTS**

GFOA Award: 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, 2004. 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.

In addition, the County issued its second consecutive Popular Annual Financial Report (PAFR) titled the "OC Citizens' Report" for the fiscal year ended June 30, 2004. The County received the GFOA's Award for Outstanding Achievement in Popular Annual Financial Reporting for this PAFR. The award is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports. In order to be awarded, a government unit must publish a PAFR to reflect the program standards of creativity, presentation, understandability and reader appeal.

Acknowledgments: 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,

David E. Sundstrom, CPA  
Auditor-Controller