## MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

This section of the County's Comprehensive Annual Financial Report (CAFR) provides a narrative overview and analysis of the financial activities of the County for the year ended June 30, 2008. We hope that the information presented here, in conjunction with the Letter of Transmittal, provides a clearer picture of the County's overall financial status. Unless otherwise indicated, all amounts in this section are expressed in thousands of dollars.

#### FINANCIAL HIGHLIGHTS

- Total net assets increased by \$108,970 or 2% as compared to last year.
- Long-term debt decreased by \$98,918, or 10% during the current fiscal year.
- As of the end of the fiscal year, the County's governmental funds reported combined ending fund balances of \$2,065,487, a decrease of \$32,576, or 2% in comparison with the prior year.
- At June 30, 2008, unreserved fund balance in the General Fund was \$36,432, or 1% of total FY 2007-08 expenditures and transfers of \$2,936,379.
- General Fund revenues and transfers ended the year 3% below budget.
- General Fund expenditures and transfers ended the year 5% below budget.

## **OVERVIEW OF THE FINANCIAL STATEMENTS**

The basic financial statements presented in the County's CAFR have been divided into three different sections:

- Government-wide Financial Statements
- Fund Financial Statements
- Notes to the Basic Financial Statements

Basic Financial Statements										
Government-wide		Fund Financial Statements	3							
Financial Statements	Governmental Funds	Governmental Funds Proprietary Funds								
Statement of	Balance Sheet	Statement of Net Assets	Statement of Fiduciary							
Net Assets	Statement of Revenues, Expenditures, and	Statement of Revenues, Expenses, and Changes in	Net Assets							
	Changes in Fund Balances	Fund Net Assets	Statement of Changes in Fiduciary Net							
Statement of Activities	Budgetary Comparison Statement	Statement of Cash Flows	Assets							
	Notes to the Basic	Financial Statements								

The following table summarizes the major features of the basic financial statements:

	Government-wide	Fund Financial Statements									
	Financial Statements	Governmental Funds	Proprietary Funds	Fiduciary Funds							
Type of Financial Statement	Statement of Net Assets	Balance Sheet	Statement of Net Assets	Statement of Fiduciary Net Assets							
	Statement of Activities	Statement of Revenues, Expenditures, and Changes in Fund Balances	Statement of Revenues, Expenses, and Changes in Fund Net Assets Statement of Cash Flows	Statement of Changes in Fiduciary Net Assets							
Scope	Entire entity (except fiduciary funds)	Day-to-day operating activities for basic services	Day-to-day operating activities for business-type services	Resources on behalf of others							
Accounting basis and measurement focus	Accrual accounting and economic resources measurement focus	Modified accrual and current financial resources measurement focus	Accrual accounting and economic resources measurement focus	Accrual accounting and economic resources focus							
Type of asset and liability information	All assets and liabilities, both financial and capital, short-term and long-term	Current assets and liabilities that come due during the year or soon thereafter	All assets and liabilities, both financial and capital, short-term and long-term	All assets held in a trustee or agency capacity for others							
Type of inflow and outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during the year or soon thereafter; expenditures when goods or services have been received and the related liability is due and payable	All revenues and expenses during the year, regardless of when cash is received or paid	All additions and deductions during the year, regardless of when cash is received or paid							

#### **Government-wide Financial Statements**

The government-wide financial statements consist of the following two financial statements: the Statement of Net Assets and the Statement of Activities. Both of these statements were prepared using an accounting method and a measurement focus similar to those used by private-sector companies, the <u>accrual basis of accounting</u> and the <u>economic resources measurement focus</u>. The **Statement of Net Assets** provides information regarding <u>all</u> of the County's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating. The **Statement of Activities**, on the other hand, provides information on how the government's net assets changed during the most recent fiscal year regardless of the period when the related cash or cash equivalent is received or paid. Therefore, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (for example, uncollected taxes and earned but unused vacation leave).

The Statement of Net Assets and the Statement of Activities distinguish functions of the County that are principally supported by taxes (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the County include (1) general government, (2) public protection, (3) public ways and facilities, (4) health and sanitation, (5) public assistance, (6) education, and (7) recreation and cultural services. The business-type activities of the County include airport and waste management.

The government-wide financial statements also provide information regarding the County's component units, entities for which the County (the primary government) is considered to be financially accountable. Blended component units, although legally separate entities, are in substance part of the County's operations, and therefore, data from these component units are combined with data of the primary government. Financial information for the Children and Families Commission of Orange County, a discretely presented component unit, is reported separately from the financial information presented for the primary government itself.

#### **Fund Financial Statements**

- Fund a separate accounting entity with a self-balancing set of accounts.
- Focus is on major funds.
- Provides information regarding the three major categories of all County funds: governmental, proprietary, and fiduciary.

The fund financial statements report on groupings of related funds that are used to maintain control over resources that have been segregated for specific activities or objectives. A fund is a separate accounting entity with a self-balancing set of accounts. Like other state and local governments, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of governmental and proprietary fund financial statements is on major funds as determined by the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 34 "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." All of the County funds can be divided into three major categories of funds: governmental, proprietary, and fiduciary.

<u>Governmental Funds</u> - Governmental funds include most of the County's basic services and are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements are prepared using the <u>modified accrual basis of accounting</u> and <u>current financial resources measurement focus</u>.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Reconciliations are prepared for both the governmental funds' Balance Sheet and the governmental funds' Statement of Revenues, Expenditures, and Changes in Fund Balances to facilitate comparisons between governmental funds and governmental activities. The primary differences between the government-wide and fund financial statements relate to noncurrent assets, such as land and structures and improvements, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund financial statements.

In FY 2007-08, an increase of \$79,041 in net assets in the government-wide financial statements was reported, and a decrease of \$32,576 in fund balance was reported in the fund financial statements. Refer to the "Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities" for details on the factors contributing to these differences.

The County maintains several individual governmental funds organized according to their type (General Fund, Special Revenue, Debt Service, Capital Projects and Permanent Funds). Information is presented separately in the governmental funds Balance Sheet and in the Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund, which is always a major fund, and all other major funds. Information for nonmajor funds is presented in the aggregate in these statements. Individual fund data for each of the nonmajor governmental funds is presented elsewhere in this report. The County adopts an annual appropriated budget for its governmental funds. Budgetary comparison statements and schedules have been provided for these funds to demonstrate compliance with the budget.

<u>Proprietary Funds</u> - The County maintains two different types of proprietary funds: Enterprise Funds and Internal Service Funds. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The County uses enterprise funds to account for its Airport and Waste Management. Internal Service Funds are used to accumulate and allocate costs internally among the County's various functions such as insurance, transportation, publishing, and information technology. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Airport and Waste Management operations, which are both considered to be major funds of the County. Conversely, the Internal Service Funds are combined into a single, aggregated presentation in the proprietary funds financial statements with the individual fund data provided in combining statements, which can be found elsewhere in this report.

<u>Fiduciary Funds</u> - Fiduciary funds include the **Trust** and **Agency** funds and are used to account for assets held on behalf of outside parties, including other governments. Financial information for fiduciary funds is <u>not</u> reported in the government-wide financial statements because the resources of these funds are not available to support the County's programs. The combining statements for fiduciary funds are included elsewhere in this report.

#### **Notes to the Basic Financial Statements**

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. To find a specific note, refer to the Table of Contents.

#### **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

As noted earlier, net assets may serve over time as a useful indicator of the County's financial position. At June 30, 2008, the County's combined net assets (governmental and business-type activities) totaled \$4,684,999, an increase of 2% from FY 2006-07.

The largest component of the County's net assets (58%) was **invested in capital assets**, **less any related outstanding debt** used to acquire those assets. Capital assets include land, structures and improvements, equipment, construction in progress, and infrastructure that are used to provide needed services to the citizens of the County.

#### **COMPONENTS OF NET ASSETS**

- Invested in Capital Assets, Net of Related Debt
- Restricted
- Unrestricted

Since the capital assets themselves cannot be used to liquidate the associated debt, the resources needed to repay the debt must be provided from other sources.

The County's **restricted** net assets total \$1,929,034 which represents 41% of its net assets. This means that these resources are subject to external restrictions on how they may be used. External restrictions include those imposed

by grantors, contributors, laws/regulations of other governments, or restrictions imposed by law through constitutional provisions or legislation, including those passed by the County itself.

The final component of net assets is **unrestricted net assets**. Unrestricted net assets are resources that the County may use to meet its ongoing obligations to citizens and creditors. As of June 30, 2008, governmental activities showed \$57,812 in unrestricted net assets, compared to \$135,826 in FY 2006-07.

The following table presents condensed financial information derived from the government-wide Statement of Net Assets:

<b>NET ASSETS – Primary Governmen</b>	nt					
June 30, 2008						
	Gover	nmental	Busine	ss-Type		
	Acti	vities	Acti	vities	To	otal
	2008	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
ASSETS						
Current and other assets	\$ 3,000,431	\$ 3,246,730	\$ 801,300	\$ 744,233	\$ 3,801,731	\$ 3,990,963
Capital assets	2,388,820	2,366,219	520,657	501,529	2,909,477	2,867,748
Total Assets	5,389,251	5,612,949	1,321,957	1,245,762	6,711,208	6,858,711
LIABILITIES						
Long-term liabilities	1,309,632	1,369,667	321,123	329,881	1,630,755	1,699,548
Other liabilities	302,208	513,682	93,246	69,452	395,454	583,134
Total Liabilities	1,611,840	1,883,349	414,369	399,333	2,026,209	2,282,682
NET ASSETS						
Invested in capital assets,						
net of related debt	2,302,926	2,273,891	395,227	359,544	2,698,153	2,633,435
Restricted	1,416,673	1,319,883	512,361	486,885	1,929,034	1,806,768
Unrestricted	57,812	135,826			57,812	135,826
Total Net Assets	\$ 3,777,411	\$ 3,729,600	\$ 907,588	\$ 846,429	\$ 4,684,999	\$ 4,576,029

As of June 30, 2008, the County's total assets decreased by 2%, or \$147,503 during the current fiscal year. Current and other assets decreased by \$189,232 (5%) primarily as a result of the amortization of the prepaid pension cost in FY 2007-08 to pay the County's annual required contribution (ARC) to the Orange County Employees Retirement System (OCERS). In January 2007, the County issued pension obligation notes in the amount of \$211,065, of which \$210,810 were used for the prepayment of FY 2007-08 pension costs. In September 1994, the County issued \$320,000 of pension obligation bonds, of which \$318,000 were deposited into a County Investment Account with OCERS to maintain and allows the County to draw down from the Investment Account over time to fund the County's portion of the pension unfunded actuarial accrued liability to OCERS. As pension costs were incurred in FY 2007-08, the prepaid cost was amortized to recognize the consumption of this asset used to fund the County's ARC. Refer to Note 19, Retirement Plans for further information. The decrease in current and other assets is also attributable to a reduction in restricted investments with trustee for retirement of long-term obligations, and a reduction in interest receivable resulting from declining yields in the County's Investment Pool. Capital assets increased by \$41,729.

Total liabilities for this year decreased by 11% or \$256,473. Other liabilities decreased by \$187,680 (32%), mostly due to the retirement of the Taxable Pension Obligation Bonds Series 2007. Long-term liabilities decreased by \$68,793 (4%) due to the retirement of long-term obligations and capital lease obligations payable. Refer to Note 12, Long-Term Obligations, for the reduction of the specific obligations.

The following table provides summarized data of the government-wide Statement of Activities:

CHANGES IN NET ASSETS – Primary Go For the Year Ended June 30, 2008	vernment					
		nmental vities		ess-Type ivities	To	otal
	<u>2008</u>	<u>2007</u>	2008	<u>2007</u>	<u>2008</u>	<u>2007</u>
REVENUES						
Program Revenues:						
Charges for Services	\$ 525,524	\$ 504,324	\$ 225,687	\$ 239,109	\$ 751,211	\$ 743,433
Operating Grants						
and Contributions	1,735,820	1,759,887	569	691	1,736,389	1,760,578
Capital Grants						
and Contributions	46,308	69,340	15,188	6,731	61,496	76,071
General Revenues:						
Property Taxes	461,682	453,541			461,682	453,541
Property Taxes in Lieu of						
Motor Vehicle License						
Fees	224,210	206,933			224,210	206,933
Other Taxes	84,434	54,644			84,434	54,644
Grants and Contributions						
not Restricted to						
Specific Programs	23,434	1,917			23,434	1,917
State Allocation of Vehicle						
Motor License Fees	54,656	58,487			54,656	58,487
Other General Revenues	94,660	153,078	32,092	35,706	126,752	188,784
Total Revenues	3,250,728	3,262,151	273,536	282,237	3,524,264	3,544,388
EXPENSES						
General Government	264,049	281,739			264,049	281,739
Public Protection	1,164,458	•			1,164,458	1,055,593
Public Ways and Facilities	131,563				131,563	96,776
	•					·
Health and Sanitation	576,160	•			576,160	527,541
Public Assistance	862,709	•			862,709	794,862
Education	37,728	32,722			37,728	32,722
Recreation and Cultural	75.040	00.070			75.040	00.070
Services	75,612	80,279			75,612	80,279
Interest on						
Long-Term Debt	76,210	65,961			76,210	65,961
Airport			86,750	90,524	86,750	90,524
Waste Management			101,990	85,378	101,990	85,378
Total Expenses	3,188,489	2,935,473	188,740	175,902	3,377,229	3,111,375
Excess	00.000	000.070	04.700	400.005	4.47.005	400.040
before Transfers and Special Items Transfers	62,239 16,802		84,796 (16,802)	106,335 (14,130)	147,035	433,013
Special Items	10,002	14,130	(6,835)		(6,835)	
Increase in Net Assets	79,041	340,808	61,159	92,205	140,200	433,013
Net Assets - Beginning	79,041	5-0,000	01,109	32,203	170,200	700,010
of the Year, as Restated	3,698,370	3,388,792	846,429	754,224	4,544,799	4,143,016
Net Assets - End	5,556,570	0,000,192	070,723	104,224	4,544,738	-1, 1-13,010
of the Year	\$ 2777.444	¢ 2700.000	¢ 007.500	\$ 040,400	£ 4.004.000	\$ 4.570.000
UI LIIC I CAI	\$ 3,777,411	\$ 3,729,600	\$ 907,588	\$ 846,429	\$ 4,684,999	\$ 4,576,029

As of June 30, 2008, the County's net assets increased by 3%, or \$140,200 during the current fiscal year. Revenues for the year totaled \$3,524,264, a decrease of \$20,124 from the previous year, and expenses totaled \$3,384,064, an increase of \$272,689.

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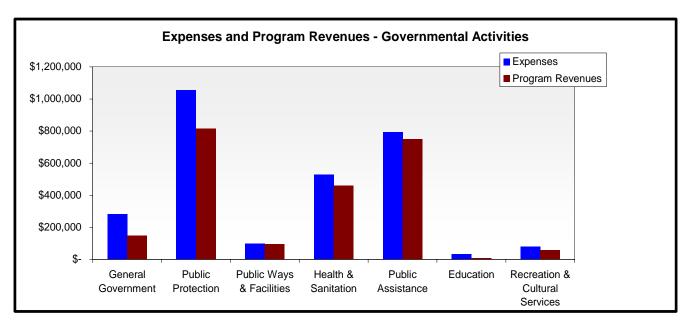
#### **Governmental Activities**

The County's governmental activities rely on several sources of revenue to finance ongoing operations. Operating grants and contributions comprised the largest revenue source for the County followed by charges for services. Operating grants and contributions are monies received from parties outside the County and are generally restricted to one or more specific programs such as the State and Federal revenues for public assistance and for health care. In the governmental funds, expenditure-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other grant requirements have been met. As expenditures increase, revenues increase proportionately. Charges for services are revenues that arise from charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided. Examples of the types of services that fall under this category include engineering services provided to cities under contract, park and recreation fees, and law enforcement services provided to governmental agencies under contract.

At the end of FY 2007-08 total revenues for the governmental activities, including transfers from the business-type activities were \$3,267,530, a decrease of \$8,751 from the previous year. Expenses totaled \$3,188,489, an increase of \$253,016 from the prior year. Governmental activities increased the County's net assets by \$79,041, accounting for 56% of the total growth in the net assets of the County. In addition to the effects of expenditure-driven grants, key elements of the increase are as follows:

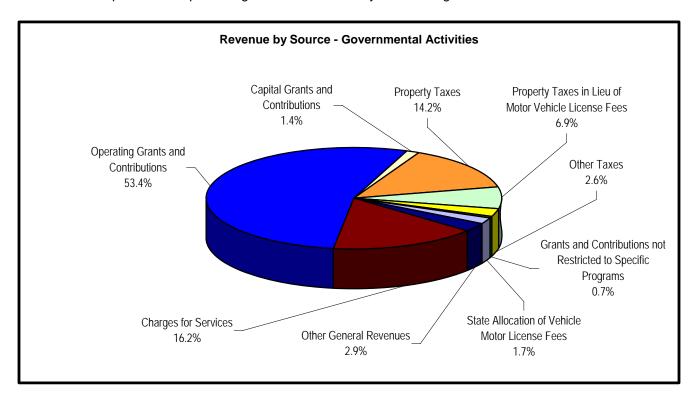
- Property taxes in-lieu of vehicle license fees (VLF) increased by \$17,277 due to the increasing assessed property values in FY 2007-08 from FY 2006-07. The property tax in-lieu of VLF is calculated as prior year's VLF amount inflated for the increase in the growth of locally assessed property values; and under Proposition 13, the taxable value of properties is limited by an inflation adjustment of up to 2% per year.
- Other taxes increased by \$29,790, primarily due to higher penalties collected from delinquent property taxes.
- Charges for services increased by \$21,200 due to the increase in the Sheriff's court security services and the recognition of reimbursed fees from the State for automated system costs and vehicle maintenance costs.
- Capital grants and contributions decreased by \$23,032 due primarily to the capital contributions from the State for the Santa Ana River Mainstem Project recorded in the prior year.
- Higher salaries (including extra-help and overtime) and pension costs were experienced in most functions and increased by approximately \$147,221 from FY 2006-07. In addition to these costs, professional services and contracts for various health and sanitation, public protection and public assistance programs increased by approximately \$165,941 from FY 2006-07. Refer to the fund analysis for additional details on the functional professional services and contracts expenses.

The following chart presents a comparison of expenses by function and the associated program revenues for governmental activities:



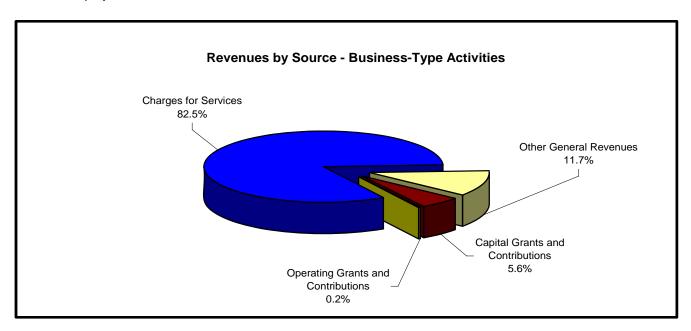
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The chart below presents the percentage of total revenues by source for governmental activities:



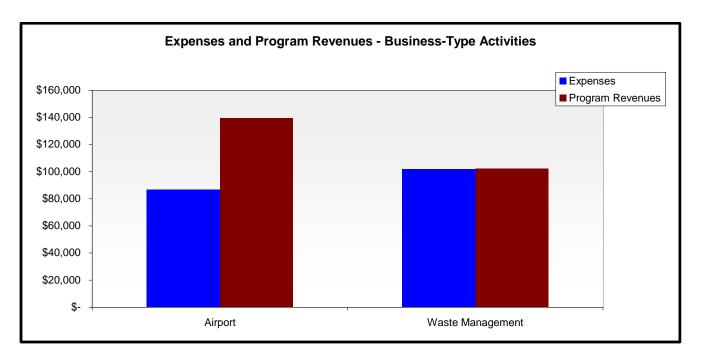
# **Business-Type Activities**

The County has two business-type activities: Airport and Waste Management. In keeping with the intent of recovering all or a significant portion of their cost through user fees and charges, business-type activities reported charges for services as their largest source of revenues. Operating grants and contributions, as well as capital grants and contributions, were the other revenue sources for Airport and Waste Management activities. Capital grants and contributions include revenues received from the Federal Aviation Administration (FAA) for use in airport construction projects.



At the end of FY 2007-08, the business-type activities' total revenues exceeded expenses resulting in an increase in net assets of \$61,159, compared to the prior year's increase of \$92,205. Revenues totaled \$273,536, a decrease of \$8,701 from the prior year; this decrease is primarily due to a smaller amount of disposal fees charged to users of the waste disposal sites than anticipated, and a decrease in interest revenue resulting from declining investment yields in the County's Investment Pool. Expenses, including transfers to the governmental activities and the special item, totaled \$212,377, resulting in an increase of \$22,345 from the previous year; the increase in expenses is primarily due to litigation settlement costs associated with the Sparks Pit Refuse Disposal Station, rising equipment maintenance costs, and an increase in the landfill site closure/postclosure costs. The program revenues (charges for services, operating grants and contributions, and capital grants and contributions) financed the majority of expenses recorded for the business-type activities. Other factors concerning the finances of the County's two enterprise funds are discussed in the Proprietary Funds section of the "Financial Analysis of the County's Funds."

The following chart displays expenses and the associated program revenues by function for the business-type activities:



#### FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

The County uses fund accounting to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

#### **Governmental Funds**

Governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Such information may be useful in evaluating the County's near-term financing requirements.

In particular, unreserved fund balance may serve as a valuable measure of the government's resources that are available for spending at the end of the fiscal year. This amount is available for spending at the discretion of the County's Board of Supervisors in order to achieve the established function of the respective funds. Other than the General Fund, all other County funds are restricted for the particular purpose that each fund was established for. For example, special revenue funds have either legal or operational requirements to restrict expenditures for specified purposes, and debt service funds are restricted for payment of principal and interest on general long-term debt.

Commitments by the County related to executory contracts for goods or services are recorded and established as reservations of fund balances in the governmental funds.

At June 30, 2008, the County's governmental funds reported total fund balances of \$2,065,487 which is a decrease of \$32,576 in comparison with the prior year. Of the total fund balances for the governmental funds, \$1,293,871 (63%) constitutes unreserved fund balances.

A significant amount of these unreserved fund balances are designated by the Board of Supervisors for the following uses in the next fiscal year and are deemed to be restrictions, commitments, or limitations, which affect the availability of fund resources in the next fiscal year:

Funds	Planned Uses of Unreserved Fund Balances
General Fund -	District community priorities and projects, re-budgeted capital projects, information systems projects and upgrades, appropriations for market adjustments, and increases to reserves.
Roads -	Construction and maintenance of roadways, and for specialized engineering services to other governmental units and the public.
Flood Control District -	Planning, construction, operation, and maintenance of regional flood protection and water conservation works, such as dams, control channels, retarding basins and other flood control infrastructure.
OC Parks -	Development and maintenance of County harbors, tidelands and related aquatic recreational facilities, as well as the acquisition, operation and maintenance of County beaches, inland regional park recreation facilities and community park sites in the unincorporated areas.
Other Public Protection -	Safety and law enforcement activities such as automated fingerprint identification systems, investigation teams and child support information.
Other Governmental -	Construction of various capital projects including affordable housing, for accounting of revenues received and reserved for future incorporation agreements, mental health services, and operational contingencies.

The remaining fund balances are *reserved*. Reserved fund balances primarily represent assets that are not available for spending or assets with restrictions imposed by parties outside the County.

## **Comparative Analysis of Changes in Fund Balances**

The following schedule presents a summary of revenues and other financing sources, expenditures and other financing uses, and the net changes in fund balances for the governmental funds for the current and previous fiscal years:

# GOVERNMENTAL FUNDS COMPARATIVE SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES For the Year Ended June 30, 2008

	Revenues	and Other	Expenditure	s and Other	Net Change in				
	Financin	g Sources	Financi	ng Uses	Fund Balances				
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>			
General Fund	\$ 2,867,612	\$ 2,627,540	\$ 2,936,379	\$ 2,601,935	\$ (68,767)	\$ 25,605			
Roads	78,564	61,031	75,515	52,401	3,049	8,630			
Flood Control District	150,215	139,729	93,047	111,116	57,168	28,613			
OC Parks	113,566	112,521	80,816	87,972	32,750	24,549			
Other Public Protection	81,591	80,409	117,440	70,333	(35,849)	10,076			
Other Governmental	517,094	586,769	538,021	484,580	(20,927)	102,189			
Total	\$ 3,808,642	\$ 3,607,999	\$ 3,841,218	\$ 3,408,337	\$ (32,576)	\$ 199,662			

<sup>\*</sup> Public Library and Tobacco Settement Special Revenues Funds have been reclassified as nonmajor Other Governmental Funds in FY 2007-08.

In addition to the effects of expenditure-driven grants, the following information provides explanations for the significant changes in fund balance:

#### General Fund

The General Fund is the chief operating fund of the County. At the end of FY 2007-08, expenditures exceeded revenues resulting in a decrease in fund balance of \$68,767 compared to last year's increase in fund balance of \$25,605. Salaries and pension costs increased by \$72,142 for Public Protection, \$18,160 for Health and Sanitation, and \$17,828 for Public Assistance. There was also a noticeable increase in professional service contract costs within the Public Assistance and Health and Sanitation functions: (1) Health Care Agency (HCA) incurred \$46,779 of additional costs for the Mental Health Services Act and the Coverage Initiative Human Services program; (2) Social Services Agency (SSA) expended \$16,084 of additional costs on Welfare-to-Work preventive services to divert families from entering the Child Welfare System and the Wraparound Program which provides individualized, comprehensive, community-based services and supports children and adolescents with serious emotional and/or behavioral disturbances so they can be reunited and/or remain with their families and communities. Property tax revenues increased by \$26,266 as a result of the annual inflation of locally assessed properties up to 2% under Proposition 13. Transfers from other funds increased by \$94,059 due to (1) reimbursement of Mental Health Services Act, Wraparound program and Tustin Family Campus project expenditures; (2) Proposition 172 (Public Safety Sales Tax) to support public safety programs, (3) monies from Tobacco Settlement to support jail operations; and (4) recording fees to the Clerk-Recorder's Office for their Archive Expansion project.

#### Roads

This fund accounts for the maintenance and construction of roadways, and for specialized engineering services to other governmental units and the public. At the end of FY 2007-08, fund balance increased by \$3,049, compared to last year's increase in fund balance of \$8,630. There was a \$17,549 increase in intergovernmental revenues due primarily to the State's allocation of Proposition 1B (Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act) general obligation bonds to the County to fund transportation projects that will benefit motorists throughout the County. Expenditures increased by \$23,114 due to a greater number of road maintenance projects undertaken in FY 2007-08, and disbursements of Proposition 1B revenues to participating cities that support Proposition 1B roadway improvement projects.

#### Flood Control District

This fund accounts for the planning, construction and operation of flood control and water conservation works, such as dams, basins, and trunk channels, and for the retardation, conservation and controlled discharge of storm waters. At the end of FY 2007-08, there was an increase in fund balance of \$57,168 compared to last year's increase in fund

balance of \$28,613. An increase of \$20,457 in intergovernmental revenues can be attributed to the receipt of higher than anticipated subvention reimbursements from the State. Property tax revenues increased by \$5,169 as a result of the annual inflation of locally assessed properties up to 2% under Proposition 13. Expenditures decreased by \$18,069 primarily due to delayed capital projects such as land acquisition for the Prado Dam project.

#### OC Parks

This fund accounts for the development of aquatic recreational facilities and the acquisition, operation and maintenance of County beaches, inland regional park recreational facilities and community park sites in the unincorporated areas. At the end of FY 2007-08, there was a \$32,750 increase in fund balance compared to last year's increase of \$24,549 in fund balance. An increase of \$3,835 in property tax revenues is attributable to the annual inflation of locally assessed properties up to 2% under Proposition 13. An increase of \$3,835 in intergovernmental revenues is primarily due to the increase in grant for Irvine Park Sewer conversion. A \$5,085 decrease in capital outlay expenditure is due to the rescheduling of the maintenance dredging and harbor revitalization projects to FY 2008-09, and the completion of the Nix Nature Interpretative Center in Laguna Coast Wilderness Park and O'Neill Park Sewer Conversion projects in FY 2006-07.

#### Other Public Protection

This group of funds is used to account for safety and law enforcement activities. Revenues consist primarily of Federal and State grants. At the end of FY 2007-08, there was a decrease in fund balance of \$35,849 compared to last year's increase in fund balance of \$10,076. There was an increase of \$3,054 in transfers of the Youthful Offender Block Grant revenues for the implementation of the Juvenile Justice Development Plan. Licenses, Permits, and Franchise revenues increased by \$2,652 related to various consumer protection litigations. The revenue increases are partially offset by a decrease in interest earnings of \$2,409. Expenditures increased by \$47,107 primarily due to higher transfers of Proposition 172 excess revenues to General Fund to support public safety.

#### Other Governmental Funds

At the end of FY 2007-08, there was a decrease in fund balance of \$20,927 compared to last year's increase in fund balance of \$102,189. Intergovernmental revenues decreased \$9,802 as a result of lower than anticipated realignment funding paid by the State. Revenues were lower overall in comparison to the previous year due to the proceeds from the Lease Revenue Refunding Bonds Series 2006 being recorded in FY 2006-07. Capital outlay expenditures increased by \$22,786 due to increases for various capital projects, including Ladera Ranch construction and Santa Ana Heights Fire Station improvements. An increase of \$14,098 in transfers was made to the General Fund for reimbursement of Wraparound caseloads and Mental Services Health Act program expenditures. Also, public assistance expenditures increased by \$9,763 due to an increase in housing assistance payments for the Section 8 Rental Assistance Program.

The following chart shows the fund balances for governmental funds for the current and previous fiscal year:

COMPARATIVE FUND BALANCE			
Governmental Funds *			
June 30, 2008 and 2007			
	2008	2007	Increase (Decrease) %
General Fund	\$ 314,973	\$ 383,740	(18)%
Roads	114,890	111,841	3 %
Flood Control District	312,427	255,259	22 %
OC Parks	121,456	88,706	37 %
Other Public Protection	197,540	233,389	(15)%
Other Governmental Funds	1,004,201	1,025,128	(2)%
Total	\$ 2,065,487	\$ 2,098,063	(2)%

<sup>\*</sup> Public Library and Tobacco Settement Special Revenues Funds have been reclassified as nonmajor Other Governmental Funds in FY 2007-08.

# **Proprietary Funds**

The proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the Airport and Waste Management, both of which are considered to be major funds of the County. Internal Service Funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

## **Comparative Analysis of Changes in Fund Net Assets**

The following table presents the enterprise funds' actual revenues and other financing sources, expenses and transfers, and changes in fund net assets for the current and previous fiscal year:

ENTERPRISE FUNDS COMPARATIVE SCHEDULE OF RE For the Year Ended June 30, 2008	VEN	NUES, EXPEI	NSE	S AND CHAN	IGE	S IN FUND N	ΙEΤ	ASSETS				
	Revenues, Contributions Expenses, Special Items Change in									n		
		and Tra	ansf	ers		and Tra	ans	fers		Fund Ne	t As	sets
		2008		2007		2008		<u>2007</u>	<u>2008</u> <u>2007</u>			2007
Airport	\$	150,745	\$	141,659	\$	94,347	\$	89,160	\$	56,398	\$	52,499
Waste Management		122,708		140,732		118,905		100,296		3,803		40,436
Total	\$	273,453	\$	282,391	\$	213,252	\$	189,456	\$	60,201	\$	92,935

#### Airport

This fund accounts for major construction and self-supporting aviation related activities rendered at John Wayne Airport (JWA). Last year's increase in fund net assets was \$52,499; this year the fund net assets increased by \$56,398 primarily due to a \$10,028 increase in capital grant contributions for the Airport Improvement Program and \$6,835 decrease in special items associated with the Parking Structure B1. Refer to Note 3, Special Items for additional details.

## Waste Management

This fund is used to account for the operation, expansion, and closing of existing landfills and the opening of new landfills. Monies are collected through gate tipping fees, which users pay based primarily on tonnage. At the end of FY 2007-08, there was an increase in fund net assets of \$3,803, compared to the prior year increase of \$40,436, primarily due to the following factors:

- An \$11,634 decrease in charges for services due to a decrease in importation tonnage.
- A \$4,447 decrease in interest revenue due to the downward trend of interest rates.
- A \$10,262 increase in maintenance costs for equipment and structures.
- A \$3,057 increase in the landfill closure and postclosure expenses.

For further comparative analysis of changes in Fund Net Assets, please see the Business-Type Activities.

#### **GENERAL FUND BUDGETARY HIGHLIGHTS**

This section provides a summary of the primary factors involved in the variances between: 1) the Original Budget and the Final Amended Budget; and 2) the Final Amended Budget and the Actual Amounts for the General Fund. In addition to the effects of expenditure-driven grants, the following information provides explanations for significant variances. Refer to the Budgetary Comparison Statement for details on this budgetary comparison.

#### Original Revenue Budget vs. Final Amended Revenue Budget

The following provides a summary of the primary factors attributable to the increase or decrease in the General Fund final amended budget revenues compared to the original budget revenues:

Intergovernmental Revenues

- A \$56,329 increase in the Child Support Services Department (CCS) due to the recognition of revenues for Federal and State funding advances.
- A \$3,710 increase in the Probation Department primarily due to revenue from the Youth Offender Block Grant to develop and implement the Juvenile Justice Development Plan.
- A \$10,349 increase in the Sheriff's Department from numerous sources, including State Homeland Security Grants, Solving Cold Cases with DNA Program, Coverdell Grants, 2005 Buffer Zone Protection Program, DNA Capacity Enhancement Program, 2007 Forensic DNA Backlog Reduction Program, DNA Expansion Demonstration program, and California Multi-Jurisdictional Methamphetamine Enforcement Team Grant. These revenues were used to provide training, hire personnel, purchase equipment, and develop strategies for various programs related to the prevention and response to terrorism and to programs dealing with the use of DNA to investigate and solve cases.

#### Charges for Services

- An increase of \$1,495 due to an increase in the fees collected for seizing unsecured property and bank accounts for delinquent unsecured property taxes, and a processing fee for the delinquent taxes made in installments.
- An increase of \$8,757 in the Sheriff Department due to finalizing new law enforcement service contracts after the Original Budget.

#### Transfers In

- A decrease of \$56,184 in the CSS due to the reclassification of Federal and State funding advances to Intergovernmental Revenues.
- An increase of \$6,403 from various sources, including the Medi-Cal Administrative Activities/Targeted Case Management, Emergency Medical Services, HCA Realignment, and Bioterrorism Special Revenue funds.
- An increase of \$6,500 in the Clerk-Recorder due to transfers of recording fees to fund the purchase of property, information technology equipment, and conversion of records to electronic format.
- An increase of \$4,503 in the SSA due to transfers of donations and grant money for the implementation of the Medi-Cal application software, "OneEApp", and a transfer from the Facilities Development and Maintenance Fund to support a potential shortfall in realignment revenue.

#### Other

 An increase of \$23,177 primarily due to the unanticipated revenue from the pass-through of bi-weekly retirement charges to departments. For generally accepted accounting principles (GAAP) purposes, this revenue is eliminated and not recorded in the governmental funds' Statement of Revenues, Expenses and Changes in Fund Balances. See Note A of the Reconciliation of the General Fund and Major Special Revenue Fund – Budgetary Comparison Statement for additional details.

# Original Expenditure Budget vs. Final Amended Expenditure Budget

The following provides a brief summary of the primary factors attributable to the increase in the General Fund final amended budget expenditures compared to the original budget expenditures:

#### **Capital Projects**

An increase of \$5,745 in appropriations primarily due to expenditures related to various capital projects, which
include the Dana Point 800 MHz project and replacement of the North Justice Center Fire Alarm System.

#### Miscellaneous

A \$22,811 increase in appropriations to cover increased retirement costs.

## Probation

 A \$7,687 increase in appropriation to develop and implement the Juvenile Justice Development Plan for juvenile offenders and to cover negotiated salary increases.

\_\_\_\_\_

# Sheriff-Coroner

 A \$22,296 increase in appropriation for the addition of personnel in various areas such as crime investigation, emergency management, forensic science, and security services; as well as the purchase of equipment needed to prepare for incidents of terrorism, and to increase the efficiency of the forensic laboratory.

#### Health Care Agency

• An increase of \$7,798 in appropriations to cover unbudgeted salary and negotiated salary increases, and to support the HCA Realignment, the Bioterrorism and the Emergency Medical Services programs.

# Social Services Agency

 An increase in appropriations of \$9,779 to add several positions to support increased workload related to Medi-Cal caseload growth and to cover negotiated salary increases.

# Final Amended Revenue Budget vs. Actual Revenue Amounts

The following information provides a summary of the primary factors that caused the variance in the General Fund actual revenues compared to the final amended budget revenues:

# Intergovernmental Revenues

- An \$18,788 negative variance for the District Attorney and the Sheriff's Department due to the decline in Proposition 172 revenue resulting from lower actual growth rate than the anticipated growth rate.
- A \$3,636 negative variance for the Watershed and Coastal Resources Agency due to less than anticipated revenues for the National Pollutant Discharge Elimination System Project and various Newport Bay Total Maximum Daily Load projects.
- A \$5,003 negative variance due to lower than anticipated revenue for motor vehicle license in-lieu fees from the State.
- A \$14,575 negative variance for HCA due to a decrease in Health and Mental Health Realignment, and Mental Health Managed Care revenues.
- A \$3,520 negative variance for the Sheriff's Department due to the timing differences for when Federal grant revenues are received and recorded.

#### **Charges for Services**

- A \$9,507 negative variance for Sheriff's Department is due to vacancies billable to Court Security and over estimated salary increases built into revenue projections, which did not materialize.
- A \$2,541 negative variance in the Clerk-Recorder's Office is due to unanticipated decrease in property recordings.
- A \$3,703 negative variance in OC Public Works due to lower than anticipated revenue resulting from lower reimbursable indirect charges.

#### Transfers In

- A \$16,261 negative variance in the HCA is primarily due to the timing of eligible expenditures for the Mental Health Services Act, Tobacco Settlement, and Emergency Medical Services programs.
- A positive variance of \$4,185 in the Sheriff's Department due to the increase from the Public Safety Sales Tax Excess Reserve Fund and the Tobacco Settlement Fund to support operations at the Theo Lacy Jail Facility.
- A \$4,757 negative variance in the AFDC-Foster Care Agency due to the lower than anticipated transfer in from the Wraparound program to fund foster care programs.
- An \$18,167 negative variance in the Capital Projects Agency because bond proceeds to reimburse construction costs for the Cogeneration at the Central Utility Facility Project did not take place in FY 2007-08.
   In addition, the Photovoltaic Project and other capital projects were cancelled and/or delayed and consequently, revenue could not be claimed for reimbursement.

## Final Amended Expenditure Budget vs. Actual Expenditure Amounts

The following provides a summary of the primary factors causing the significant variance in the General Fund actual expenditures as compared to the final amended budget expenditures:

## Capital Projects

 A \$35,676 positive variance because of the cancellation of the Photovoltaic Project and the deferral of various capital projects such as the County Facilities Master Plan, Deferred Maintenance Projects for the Sheriff Department, and Multipurpose Service Center Project for the homeless and for veterans.

## **Sheriff-Coroner**

 A \$21,964 positive variance resulting from cost saving strategies, a reduction in insurance costs, and a delay in eligible expenditures for Homeland Security Grants.

#### **OC Public Works**

 An \$18,940 positive variance due to cost reduction measures and increased cost reimbursement from other agencies.

#### Health Care Agency

A positive variance of \$24,053 primarily due to delays in the start-up of the Mental Health Services Act
Program contracts, Coverage Initiative Human Services contracts, the Animal Shelter Development capital
project, and purchases of equipment for the Water Quality Lab and Environmental Health, as well as
cancelling a remodeling project for Information Technology.

#### Watershed and Coastal Resources

• An \$8,376 positive variance due to the lower than anticipated costs for the Upper Newport Bay Restoration Project and the National Pollutant Discharge Elimination System program.

#### Social Services Agency

A \$18,540 positive variance due to refunds from worker's compensation and retirement that were not
anticipated in the budget, reducing costs for equipment and information technology support by utilizing inhouse resources; and a reduction in the CalWIN implementation expenses.

## **Capital Assets**

At June 30, 2008, the County's capital assets for both the governmental and business-type activities amounted to \$2,909,477 net of accumulated depreciation. The investment in capital assets includes land, structures and improvements, equipment, infrastructure (roads, bridges, flood channels, trails, traffic signals, and harbors), and construction in progress. The total increase in the County's investment in capital assets for the current year was 1.5%.

Capital assets for the governmental and business-type activities are presented below to illustrate changes:

CAPITAL ASSETS (Net of Depreciation)										
June 30, 2008										
	Govern	nme	ntal	Busine	ss-	Гуре				Increase
	Activ	/itie	s	Activ	vitie	s	To	tal		(Decrease)
	<u>2008</u>		2007	2008		<u>2007</u>	<u>2008</u>		2007	% Change
Land	\$ 610,889	\$	606,166	\$ 38,058	\$	38,058	\$ 648,947	\$	644,224	0.7 %
Structures and										
Improvements	525,604		509,032	172,046		183,975	697,650		693,007	0.7 %
Equipment	97,582		96,589	34,436		31,542	132,018		128,131	3.0 %
Infrastructure	837,511		837,805	200,069		214,264	1,037,580		1,052,069	(1.4)%
Construction in										
Progress	317,234		316,627	76,048		33,690	393,282		350,317	12.3 %
Total	\$ 2,388,820	\$	2,366,219	\$ 520,657	\$	501,529	\$ 2,909,477	\$	2,867,748	1.5 %

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The following lists the significant expenditures for capital assets in FY 2007-08:

## General Fund

- \$8,591 for the Cogeneration Plant at the Central Utilities Facility.
- \$5,685 for the renovation of the sixth floor of the Central Justice Center including Heating, Ventilation, and Air Conditioning (HVAC) system upgrades and an Americans with Disabilities Act (ADA) compliance retrofit.
- \$1,230 for the construction of the Public Health Services' Shellmaker Water Quality Laboratory to help detect and eliminate pollution sources in Orange County.
- \$1,764 for the development and shared ownership of a Multi-County Electronic Recording Delivery System that will increase security of public records and extend electronic recording services to customers statewide.
- \$2,103 for the Clerk-Recorder's expansion of its electronic archives.
- \$1,302 for the expansion of the Loma Ridge Emergency Operation Center.

#### Flood Control District

- \$1,767 for the construction of a new pump and pump house at the Los Alamitos Pump Station.
- \$1,662 for the Peters Canyon Channel Trail Undercrossings construction project.
- \$8,145 for the East Garden Grove Wintersburg Channel North Levee Emergency project.
- \$6,523 for the construction of the Fullerton Creek Channel.
- \$2,468 for the acquisition of property in the flood plain or in the right-of-way construction area for the Prado Dam project.

# <u>Airport</u>

- \$14,984 for the gate expansion of the terminal building.
- \$3,043 for the remodeling of restrooms in the terminal building.
- \$21,320 for the construction of the new South Remain Over Night (RON) airplane parking.
- \$2,843 for the design of a new parking structure, as part of Airport's Improvement Program.
- \$1,586 for the surfacing/construction of a temporary parking lot.

## Waste Management

\$2,582 for the Brea Soil Removal Project.

Additional information on the County's capital assets can be found in Note 6, Changes in Capital Assets.

#### Commitments for Capital Expenditures

At the end of FY 2007-08, significant commitments for capital expenditures included the following:

- \$301,400 for the Santa Ana River Mainstem Project.
- \$22,132 for the Cogeneration Plant at the Central Utilities Facility.
- \$8,860 for HVAC and ADA improvements at the Central Justice Center.
- \$5,664 to widen Irvine Avenue from Mesa Drive to Bristol Street.
- \$19,948 for a new pump and pump house at the Los Alamitos Pump Station.
- \$11,725 for the San Juan Creek Channel improvement project.
- \$13,668 for the construction of the Tustin Family Campus. The campus will be a multi-treatment facility that will provide specialized residential treatment and services for children and families, and emancipated young adults in Orange County.
- \$15,076 for gate expansion of the terminal building for John Wayne Airport.
- \$9,757 for the new South RON airplane parking for John Wayne Airport.
- \$6,658 for the deconstruction of the B1 parking structure for John Wayne Airport.
- \$11,614 for the temporary landslide backcut excavation project.

Additional information on the County's commitments for capital expenditures can be found in Note 16, Construction and Other Significant Commitments.

## Long-Term Debt

At June 30, 2008, the County had a total debt obligation outstanding of \$912,426, excluding capital lease obligations, compensated absences and other liabilities. During the year, \$102,632 of the bonds, including \$58,790 of bankruptcy related debt, were retired, which resulted in a net decrease of 10% on the County's outstanding bond obligation. The County is limited by law in issuing general obligation bonded debt to 1.25 percent of the last equalized assessment property tax roll. However, this does not affect the financing of any of the County's planned facilities or services because as of the end of the fiscal year, the County had no net general obligation bonded debt. The County's debt obligations are in the form of revenue bonds, certificates of participation (COPs), and other forms of debt not covered by the general obligation bonded debt limitation.

The following table summarizes the County's outstanding bonds at June 30, 2008:

LONG-TERM DEBT BOND June 30, 2008	ОВ	LIGATIONS									
		Govern	me	ntal	Busine	S	s-Type				Increase
		Activ	s	Activ	vi	ities	To	tal		(Decrease)	
		2008		<u>2007</u>	<u>2008</u>		<u>2007</u>	2008		<u>2007</u>	% Change
Revenue Bonds	\$	598,210	\$	652,340	\$ 130,550	\$	\$ 148,345	\$ 728,760	\$	800,685	(9)%
Certificates of											
Participation		6,306		7,165				6,306		7,165	(12)%
Pension Obligation											
Bonds		72,728		89,891				72,728		89,891	(19)%
Recovery Bonds		106,751		119,436				106,751		119,436	(11)%
Add: Premium on											
Bonds Payable		34,524		35,408	2,174		2,740	36,698		38,148	(4)%
Less: Deferred											
Amount on Refunding		(32,167)		(35,702)	(6,650)		(8,279)	(38,817)		(43,981)	(12)%
Total	\$	786,352	\$	868,538	\$ 126,074	\$	142,806	\$ 912,426	\$	1,011,344	(10)%

Additional information on the County's long-term debt activity can be found in Note 12, Long-Term Obligations.

# **Bond Ratings**

The County continues to maintain the issuer ratings of Aa2 from Moody's Investors Service and AA- from Standard & Poor's (S&P); currently Fitch Ratings does not provide issuer ratings. The 1995 Teeter Plan Revenue Bonds and the Orange County Development Agency (OCDA) 2003 Santa Ana Heights (SAH) Bonds are AAA insured from Fitch Ratings and S&P with a municipal bond insurance policy, but are not currently rated (NR indicates Not Rated).

In FY 2007-08, the following changes occurred in the County's underlying debt ratings as compared to the previous year:

- Improved S&P Rating from A to A+ for the OCDA Neighborhood Development and Preservation Project Tax Allocation Refunding Bonds.
- Changed Fitch Rating from not rated to AA- for the 1996 Pension Obligation Bonds.

Due to the challenges facing the bond market and bond insurers, Fitch Ratings has decided to withdraw its ratings for Ambac Financial Group and its insured bonds. The 1991 Parking COPs, the OCDA 2003 SAH Bonds, the 1995 Teeter Plan Revenue Bonds, and the 2001 Lease Revenue Bonds are insured by Ambac Financial Group.

The County maintains the following long-term underlying debt ratings:

LONG-TERM DEBT RATINGS June 30, 2008			
	Standard and Poor's	Moody's	Fitch
2005 Refunding Recovery Bonds	A+	Aa3	AA-
2005 Lease Revenue Bonds	A+	A1	AA-
1991 Parking COPs	NR	A1	WD
OCDA Neighborhood Development and Preservation			
Project Tax Allocation Refunding Bonds	A+	A2	NR
2002 Lease Revenue Bonds	A+	A1	AA-
2006 Lease Revenue Bonds	A+	A1	AA-
OCDA 2003 SAH Tax Allocation Revenue Bonds	NR	NR	WD
1996 Pension Obligation Bonds	NR	Aa2	AA-
1997 Pension Obligation Bonds	NR	Aa2	AA-
1995 Teeter Plan Revenue Bonds	NR	NR	WD
2001 Lease Revenue Bonds	NR	A2	WD
Airport 1997 Revenue Refunding Bonds	A+	Aa3	AA-
Airport 2003 Revenue Refunding Bonds	A+	Aa3	AA-
Integrated Waste Management Department 1997 Revenue			
Refunding Bonds	NR	A1	A+

#### OTHER POTENTIALLY SIGNIFICANT MATTERS

The County's management has determined that the following are significant matters that have a potential impact on the County's financial position or changes in financial position:

#### **Governmental Activities**

## State Legislation and Budget

The Governor signed the FY 2008-09 State budget on September 23, 2008. In comparison to the budget approved by the Assembly, the \$144,500,000 final budget reflects a reduction of \$510,000 for line-item vetoes and \$340,000 in savings due to the delay in adopting the budget. The general fund portion is \$103,400,000 with a \$1,700,000 reserve. Although the budget is balanced for FY 2008-09, many of the balancing solutions are from one-time sources. Consequently, the Governor projects that the State will begin FY 2009-10 with a \$1,100,000 deficit and face significant challenges in adopting a final budget.

Included with the passage of the budget, the Legislature approved the Governor's budget reform package, which will require a constitutional amendment to be considered by the people in a June special election. The reform package establishes a Budget Stabilization Fund (BSF) that requires a deposit of at least 3% of general fund revenues each year. The fund will grow to an amount equal to 13% of the general fund revenues, with use of the fund restricted to deficit years. The special election will also include a proposal to modify the lottery program to allow for securitization of future lottery proceeds. Without voter approval of the lottery program changes, the State budget deficit will grow by an additional \$6,000,000 in FY 2009-10.

Following the passage of the State budget in September, the budget focus shifted immediately to the revenue assumptions included in the adopted budget. The budget projects growth in income and sales tax revenue that appear difficult to achieve in today's turbulent economy. A review of the first quarter data supports these concerns with personal income tax and sales tax receipts through September showing a net decline compared to FY 2007-08. Additionally, median home prices have fallen sharply, with many counties reporting over 30% declines year over year. The potential impact to local property taxes may require additional State funding for schools in order to meet the Proposition 98 funding guarantee. If the current revenue trends continue, the State will face significant budget deficits that require a mid-year special session to balance the budget.

State budget highlights are summarized below by County budget program. Amounts quoted are statewide unless otherwise noted.

## Public Safety

- Citizens Options for Public Safety (COPS) and the Juvenile Justice Crime Prevention Act (JJCPA) are funded at \$107,100 each. This funding represents a 10% reduction.
- Juvenile Probation and Camps Funding (JPCF) is funded at \$181,300. This funding represents a 10% reduction.
- Mentally III Offender Crime Reduction Grant (MIOCR) funding is eliminated.

#### Health & Social Services

- Medi-Cal administration for counties funded at \$1,500,000. This represents a funding reduction of \$106,800, including a \$64,600 reduction to the Cost of Living Adjustment and \$42,200 reduction to caseload growth costs.
- Food Stamp administration for counties funded at \$696,000. This represents a funding reduction of \$20,900.
- In-Home Supportive Services administration for counties funded at \$254,000. This represents a funding reduction of \$12,700.
- Cal-WORKs reduction for employment services and pay for performance incentives are funded at \$1,400,000. This represents a funding reduction of \$120,600.
- Proposition 36 (Substance Abuse & Crime Prevention Act) and Offender Treatment Program are funded at \$108,000. This represents a 10% reduction.
- California Children's Services funded at \$35,800. This represents a funding reduction of 4%.
- Mental Health Managed Care funded at \$225,000. This represents a funding reduction of 6%.

# Housing, Land Use and Transportation

- Proposition 42 (Transportation Congestion Improvement Act) funding for counties for maintenance and repair to improve local transportation systems was fully funded at \$286,000.
- Proposition 1B (Highway Safety, Traffic Reduction, Air Quality, and Port Security) funding for counties for local streets and roads improvement projects is funded at \$63,000.

#### General Government

- State mandate reimbursement (SB 90) for old claims was deferred, resulting in a reduction of \$75,000.
- Presidential Primary cost reimbursement to counties is funded at \$85,700.
- Redevelopment Education Revenue Augmentation Fund shifts equal to the greater of \$350,000 or 5% from redevelopment agencies.

## Deterioration of the 2008-09 State Budget

On November 6, 2008, the Governor called a Special Session of the Legislature to address the State's growing budget deficit. The revenues included in the budget are projected to fall \$10,700,000 short, and combined with other mid-year adjustments, the total budget shortfall is estimated at \$11,200,000. The Governor's Special Session Proposal includes \$4,500,000 in program reductions and \$4,700,000 in revenue enhancements. The most significant components of the proposal include a 1.5% sales tax increase, which is projected to generate \$3,500,000 revenue, and a \$2,500,000 reduction to Proposition 98 spending. Proposal items directly affecting counties include reductions to probation camps funding, and administrative cost support for various social services and health care programs. The Legislature had until November 30 to consider and act on these proposals, but new legislation had not been passed to adopt these proposals.

On December 1, 2008, the Governor declared a fiscal emergency for the State, allowing him to call a Proposition 58 legislative special session to address the State's economy. Under Proposition 58, the legislature has 45 days to pass and send a bill or bills to the Governor's desk addressing the State's budget crisis. If the 45 days pass and the legislature have not passed bills to address the problem, they cannot adjourn or act on other bills until the State's fiscal emergency is addressed.

On December 9, 2008, the Senate and the Assembly met in a joint session to discuss the State's financial crisis and to receive presentations from the State Treasurer, Controller, and Legislative Analyst's Office. The estimated State budget shortfall through FY 2009-10 is estimated at \$41,800,000. To date, no specific actions have been agreed to, however, the State's Budget Subcommittees will continue to meet through the month to identify solutions.

The County will continue to monitor the State's actions on the budget and provide the Board of Supervisors (Board) with an analysis of impacts to County services for FY 2008-09. The County Executive Office has requested that each agency/department develop a contingency plan that assumes a 5% reduction to county general fund support for FY 2008-09. In addition to the 5% reduction, additional cuts may be needed in agencies that tie to State revenues in order to balance the budget. During the November 25, 2008 Board meeting, the Board voted to cut \$32,000 from the FY 2008-09 budgets with no layoffs or furloughs for County employees. This planning effort is intended to prepare the County to react quickly and efficiently to any impacts from the State and/or the failing economy.

## Cash Flow Management

On September 16, 2008, the County of Orange issued \$100,000 in Tax and Revenue Anticipation Notes (TRANs) to finance seasonal cash flow requirements during Fiscal Year 2008-09. The proceeds from the TRANs cover anticipated cash deficits resulting from the uneven flow of revenues. County General Fund expenditures occur in relatively level amounts throughout the year, while receipts follow an uneven pattern. Secured property tax installments, which represent the largest component of general purpose revenues, are primarily received in December and April of each year. Secured tax apportionments to the General Fund as of December 10, 2008 were \$1,750 over the previous year, representing a 1.64% increase. Additionally, the late adoption of the final State budget resulted in significant delays to the reimbursement of many health and human service programs administered by the County. The County will repay the TRANs borrowing by June 30, 2009 from available cash balances within the General Fund.

# **Long-Term Financial Planning**

#### County Accounting and Personnel System (CAPS) Upgrade

CAPS is a vital part of the County's infrastructure that is needed for business processes such as financial planning and budget development, maintaining the County's financial records, collecting costs for federal and state claiming, procuring goods and services, paying vendors, processing the County's payroll, and administering enterprise-wide human resource functions. CAPS maintains financial records for the County's budget of approximately \$5,200,000 and maintains human resource (HR) records and processes payroll for a work force of over 18,000 employees.

CAPS is based on 1980s technology and is becoming costly to maintain and operate. In addition, the vendor has informed the County that it will discontinue support of the version of software deployed at the County, within the next three to five years. The County has an action plan to upgrade its current financial application, which will reduce system support operations and maintenance costs and allow for growth for the next 15 years.

In June 2007, the County contracted with CGI, Inc. to assist in the implementation of the CGI Financial and Procurement software. This project is in progress with a phase 1 implementation date of July 2009 and phase 2 by July 2011. The total estimated project cost is \$42,424 (phase 1 - \$34,841, phase 2 - \$7,583).

Phase 1 will implement the County's primary operational needs to support the following areas:

- Chart of Accounts
- Capital Assets
- Disbursements
- Cost Accounting
- Procurement

## Phase 2 implementation may provide:

- Accounts Receivable/Collections
- Vendor Self Service
- Performance Budget
- Year-End Closing

The County also looked for similar alternatives for the HR application and contracted with AgreeYa Solutions, Inc. to assist in the analysis of alternatives. These alternatives were documented and presented to the County in January 2008. Based on these findings the County Board of Supervisors approved the directions that the HR applications would precede with a detailed CGI Fit Analysis.

toward the HR Upgrade scheduled for completion in January 2011. Currently, we have no estimate for the cost of this upgrade.

This project will include the following analysis:

- Quantify the level-of-effort and related costs to implement a solution
- Identify a technically capable and cost effective platform to run the system
- Develop a project plan, with required funding, for the implementation

#### Property Tax Management System Upgrade

The County's property tax assessment, collection and allocation system processes approximately \$6,000,000 annually in property taxes for the cities, school districts and special districts within the County. The current system was developed in the late 1980s in an obsolete programming language. Maintenance of the system requires specialized knowledge that is hard to obtain. Under direction from the Board of Supervisors to rewrite the system and to respond to the Grand Jury's recommendation to replace the mainframe with an open system platform, the Auditor-Controller, Clerk of the Board, and Treasurer-Tax Collector embarked on a multi-year phased implementation of the new Property Tax Management System (PTMS).

In January 2006, a contract was awarded to Sierra Systems to conduct a Needs Assessment Project and to document the requirements of the new PTMS. This project also included documenting the business rules, identifying areas for improvement, and creating a blueprint for implementation.

The Needs Assessment Project was completed in July 2007 at a cost of \$1,600. A Request for Proposal was released in August 2007 and Tata Consultancy Services (TCS) was selected in April 2008 to develop and implement the new PTMS based on the requirements specification documented during the needs assessment. The development and phased implementation of the replacement application is expected to take two to three years to complete at an estimated cost between \$18,000 to \$25,000, including County and contractor staffing.

Refer to Note 21, Subsequent Events for details on the approval of the contract with TCS on July 2008.

## Assessment Tax Systems (ATS) Re-Engineering

The Assessor is mandated under the provisions of the California State Constitution and the Revenue and Taxation Code to discover and value all tangible properties in the County of Orange. The total assessed value for the 2008 annual roll was over \$424,000,000, which impacts the billing and collection of over \$6,000,000 in tax revenue to support the operations of the schools, cities, special districts, and the County.

The ATS is a mainframe application that has been used by the Assessor since 1987. The vendor support for the programming language (IDEAL) for the current ATS is being phased out. Starting in 2006, under the approval of the County Board of Supervisors as a Strategic Initiative, a project to re-engineer the Assessor ATS was initiated. The new ATS will adopt current open platform and work flow technologies to enhance the user interface and strengthen the effectiveness and efficiency of property valuation and assessment.

The Assessor has assembled a project team made up of in-house managers and subject matter experts, County Affiliated Computer Services (ACS) contract staff, and outside vendors to complete this work. The project is scheduled to be completed in FY 2010-2011. The total estimated cost for the project at this time is \$20,000 to \$22,000.

#### Teeter Plan Restructuring

On June 29, 1993, the Board of Supervisors adopted the Teeter Plan pursuant to Sections 4701 through 4717 of the California Revenue and Taxation Code. The taxing agencies in Orange County that participate in the Teeter Plan program annually receive the full amount of their share of taxes from the secured property tax roll, whether or not these taxes have been collected. The Teeter Plan provides these participating agencies with stable and timely cash flow without the collection risk, and the County receives the delinquency penalties and interest amounts when the taxes are paid.

On June 27, 1995, the Orange County Special Financing Authority (Authority) issued the Taxable and Taxexempt Teeter Plan Revenue Bonds, Series A through E totaling \$155,000. Revenues from the Teeter Plan pay the bond debt service as well as the Authority's annual purchase of unpaid secured property tax receivables (Current Year Teeter Buyout) from the County at a purchase price that does not exceed 100% of the property tax

due excluding penalties. In the event that the Authority does not have sufficient monies available to purchase the annual unpaid secured property taxes receivables, the County's General Fund is obligated to cover the cash shortfall since the County must pay the participating taxing agencies 100% of the unpaid secured property taxes attributable to such agencies.

As a result of substantial increases to the annual amount of unpaid delinquencies subject to the Teeter Plan over the past two years, the Board of Supervisors authorized a Commercial Paper Program for the purpose of refunding the Authority Teeter Bonds and the Teeter Plan Notes issued July 10, 2008, as well as providing a continuing source of funding for the County's annual obligation to make distributions to the participating taxing agencies. The County implemented its Commercial Paper Program on August 26, 2008 (see Note 21, Subsequent Events). The Commercial Paper and its credit enhancement will be secured by certain delinquent tax payments and the County General Fund.

Refer to Note 21, Subsequent Events, for details on the specific financing transactions related to the Teeter program.

#### Airport Improvement Program

The Airport Improvement Program will create additional terminal area capacity in the form of new aircraft gates, hold rooms, concessions, passenger/baggage screening capabilities, and more parking. It will also help redistribute traffic between Terminals A, B and C, thus achieving a balanced operation throughout the terminal complex. A key objective of the Airport Improvement Program is to ensure that the new facilities are designed and developed in a way that creates a single, seamless environment for passengers.

Pursuant to the comprehensive financial program approved by the Board of Supervisors in December 2005 (and updated in mid-2007), JWA has implemented the financing plan for the Airport's Improvement Program, which is estimated to cost approximately \$652,000. The capital costs are anticipated to be funded from various sources, including: (i) Airport funds (ii) FAA Airport Improvement Program grants (iii) Transportation Security Administration (TSA) grants (iv) Passenger Facility Charge revenues (v) general airport revenue bonds and (vi) short-term lines of credit. As is the case with any substantial capital improvement program, JWA anticipates encountering many challenges in balancing the current level of operation and high standards for customer service with the substantial construction activity. Refer to Note 21, Subsequent Events, for additional information on the Airport's Improvement Plan.

#### Funding Progress of the County's Retirement System

The funded ratio of the System is a measure of the ability of the System to make obligated payments to current retirees and future retirees. The funded ratio (actuarial value of plan assets divided by actuarial accrued liability) has dropped from 82.76% in 2002 to 70.85 % in 2004. Since 2004, the funded ratio has increased to 72.92% as of December 31, 2007 (refer to the Required Supplemental Information, Orange County Employees Retirement System Schedule of Funding Progress for Years Ended December 31). The decline in funding status is caused by multiple factors, including changes in actuarial assumptions, changes in methodology, and enhancement of retirement benefits. Anticipated market losses during 2008 will result in increased employer contributions during the County fiscal year 2010-2011.

On November 4, 2008, the voters in Orange County approved Measure J, which requires voter approval for any future pension benefit enhancements. The County carefully monitors the activities at OCERS and regularly provides input to the OCERS management and provides input at OCERS Board meetings as deemed appropriate.

# **Requests for Information**

We hope that the preceding information has provided a general overview of the County's overall financial status. For questions or comments concerning information contained in this report, please contact the Auditor-Controller's Office, County of Orange, 12 Civic Center Plaza, Santa Ana, CA 92702 or you can access our website at http://www.ac.ocgov.com.