

COUNTY OF SANTA CRUZ, CALIFORNIA
Management's Discussion and Analysis
Year Ended June 30, 2002

This section of the County of Santa Cruz (the "County") comprehensive annual financial report presents a discussion and analysis of the County's financial performance during the fiscal year ended June 30, 2002. Please read it in conjunction with the transmittal letter at the front of this report and the County's basic financial statements following this section.

FINANCIAL HIGHLIGHTS

- The assets of the County exceeded liabilities at the close of the 2001-2002 fiscal year by \$115,530,826 (*net assets*). Of this amount, \$52,737,992 (*unrestricted net assets*) may be used to meet ongoing obligations to citizens and creditors, \$29,113,025 is restricted for specific purpose (*restricted net assets*), and \$33,679,809 is invested in capital assets, net of related debt.
- The government's total net assets decreased by \$7,754,775 (exclusive of prior period adjustment). This decrease is mostly attributable to the repeal of the Utility Users Tax and the use of designated amounts that were spent on the Road Pavement Project.
- As of June 30, 2002, the County's governmental funds reported combined ending fund balances of \$177,057,075, an increase of \$3,462,932 in comparison with the prior year. Approximately 68% of the combined fund balances, \$119,918,733 is available to meet the County's current and future needs (*unreserved fund balance*).
- At the end of the fiscal year, unreserved fund balance for the general fund was \$33,560,911 or 12% of total general fund expenditures. This amount is budgeted to be spent in the next fiscal year, except for \$809,984 an increase to the designation for fiscal uncertainty.
- The County's total long-term debt increased by \$12,042,904 in comparison with the prior year (excluding compensated absence, estimated claims, and postclosure liability). The increase resulted primarily from the issuance of the Public Financing Authority 2001B Lease Revenue Bonds of \$11,900,000.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements comprise three components: (1) **Government-wide** financial statements, (2) **Fund** financial statements, and (3) **Notes** to the basic financial statements. Required Supplementary Information is included in addition to the basic financial statements.

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Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the County's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all County 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 or not the financial position of the County is improving or deteriorating.

The *statement of activities* presents information showing how the County's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods, such as revenues pertaining to uncollected taxes and expenses pertaining to earned but unused vacation and sick leave.

Both of these government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (*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 general government, public protection, health and sanitation, public assistance, education, recreation and culture, and public ways and facilities. The business-type activities of the County include the County Disposal Sites CSA, Boulder Creek CSA, Rolling Woods CSA, Septic Tank Maintenance CSA, Freedom County Sanitation District, Davenport Sanitation District, Place de Mer CSA, Sand Dollar Beach CSA, Trestle Beach CSA, Summit West CSA, and Graham Hill CSA operations.

Component units are included in our basic financial statements and consist of legally separate entities for which the County is financially accountable and that have substantially the same board as the County or provide services entirely to the County. The Santa Cruz County Sanitation District is reported as a discretely presented component unit of the County. The District is managed by the County Department of Public Works and provides sanitation services to the unincorporated areas of the County.

Fund Financial Statements

The fund financial statements are designed to report information about groupings of related accounts which are used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

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Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements—i.e. most of the County's basic services are reported in governmental funds. These statements, however, focus on (1) how cash and other financial assets can readily be converted to available resources and (2) the balances left at year-end that are available for spending. Such information may be useful in determining what financial resources are available in the near future to finance the County's programs.

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. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains several individual governmental funds organized according to their type (general, special revenue, debt service, and capital projects). Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the general fund and the Redevelopment Agency, which are considered to be major funds. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements elsewhere in this report.

The County adopts an annual appropriated budget. The budget is a compilation of operating budgets from: individual functional units within the General Fund, Special Revenue Funds, Capital Projects Funds, and Proprietary Funds (operating plans). Budgets are adopted for all funds except for Debt Service Funds and certain special revenue funds, namely, Public Finance Authority, Health Services, and Health and Sanitation Funds. A budgetary comparison schedule has been provided for the General Fund and Special Revenue-Redevelopment Agency to demonstrate compliance with these budgets.

Proprietary funds are generally used to account for services for which the County charges customers—either outside customers, or internal units or departments of the County. Proprietary funds provide the same type of information as shown in the government-wide financial statements, only in more detail. The County maintains the following two types of proprietary 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 the operations of the County Disposal Sites CSA, Boulder Creek CSA, Rolling Woods CSA, Septic Tank Maintenance CSA, Freedom County Sanitation District, Davenport Sanitation District, Place de Mer CSA, Sand Dollar Beach CSA, Trestle Beach CSA, Summit West CSA, and Graham Hill CSA operations.

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- **Internal Service funds** are an accounting device used to accumulate and allocate costs internally among the County's various functions. The County uses internal service funds to account for its central duplicating, information services, public works, service center, and self-insurance (risk management, dental and health, liability and property, workers' compensation, employee benefit staffing, and state unemployment insurance) functions. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements. The internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the County. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the County's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds except for agency funds.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning the County's progress in funding its obligation to provide pension benefits to its employees.

Combining Statements

The combining and individual fund statements and schedules referred to earlier in connection with non-major governmental funds, enterprise and internal service funds, and fiduciary funds are presented immediately following the required supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

This year is the first year that the County has presented its financial statements under the new reporting model required by the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis (MD&A) – for State and Local Governments*. Because this reporting model changes significantly both the recording and presentation of financial data, the County has not restated prior fiscal years for the purposes of providing comparative information for the MD&A. However, in future years, when prior-year information is available, a comparative analysis of government-wide data will be included in this report.

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Net Assets

| | <u>Governmental Activities</u> | <u>Business-type Activities</u> | <u>Total</u> |
|---|------------------------------------|-------------------------------------|----------------------|
| Assets: | | | |
| Current and other assets | \$253,925,889 | \$26,396,080 | \$280,321,969 |
| Capital assets | <u>93,506,619</u> | <u>22,117,405</u> | <u>115,624,024</u> |
| Total assets | <u>347,432,508</u> | <u>48,513,485</u> | <u>395,945,993</u> |
| Liabilities: | | | |
| Current and other liabilities | 94,562,277 | 1,587,194 | 96,149,471 |
| Long-term liabilities | <u>179,264,844</u> | <u>5,000,852</u> | <u>184,265,696</u> |
| Total liabilities | <u>273,827,121</u> | <u>6,588,046</u> | <u>280,415,167</u> |
| Net assets: | | | |
| Invested in capital assets, net of related debt | 14,260,350 | 19,419,459 | 33,679,809 |
| Restricted net assets | 28,822,444 | 290,581 | 29,113,025 |
| Unrestricted net assets | <u>30,522,593</u> | <u>22,215,399</u> | <u>52,737,992</u> |
| Total net assets | <u>\$ 73,605,387</u> | <u>\$41,925,439</u> | <u>\$115,530,826</u> |

Analysis of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. For the County, assets exceeded liabilities by \$115,530,826 at the close of the current fiscal year.

The largest portion of the County's net assets (46%) represents the unrestricted net assets, \$52,737,992 which may be used to meet the government's ongoing obligations to citizens and creditors.

The \$33,679,809 (29%) reflects its investment in capital assets (e.g. land, building and structures, and equipment), less any related debt used to acquire those assets that is still outstanding. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the County's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the County's net assets, \$29,113,025 (25%) represents resources that are subject to external restrictions on how they may be used.

At the end of the current fiscal year, the County reported positive balances in all three categories of net assets, both for the County as a whole, as well as for its separate governmental activities.

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Changes in Net Assets

| | <u>Governmental</u> <u>Activities</u> | <u>Business-type</u> <u>Activities</u> | <u>Total</u> |
|------------------------------------|--|---|----------------------|
| Revenues: | | | |
| Program revenues: | | | |
| Charges for services | \$ 54,793,723 | \$10,947,617 | \$ 65,741,340 |
| Operating grants and contributions | 187,809,995 | 534,212 | 188,344,207 |
| Capital grants and contributions | - | 6,524 | 6,524 |
| General revenues: | | | |
| Property taxes | 55,625,116 | - | 55,625,116 |
| Other taxes | 19,800,407 | - | 19,800,407 |
| Interest and investment income | 7,682,370 | 856,389 | 8,538,759 |
| Miscellaneous | <u>11,268,371</u> | <u>86,640</u> | <u>11,355,011</u> |
| Total revenues | <u>336,979,982</u> | <u>12,431,382</u> | <u>349,411,364</u> |
| Expenses: | | | |
| General government | 24,700,704 | - | 24,700,704 |
| Public protection | 100,368,360 | - | 100,368,360 |
| Health and sanitation | 76,974,991 | - | 76,974,991 |
| Public assistance | 87,275,868 | - | 87,275,868 |
| Education | 3,132,635 | - | 3,132,635 |
| Recreation and culture | 7,552,638 | - | 7,552,638 |
| Public ways and facilities | 32,544,591 | - | 32,544,591 |
| Interest on long-term debt | 12,837,784 | - | 12,837,784 |
| County Disposal Sites CSA | - | 9,750,973 | 9,750,973 |
| Boulder Creek CSA | - | 376,962 | 376,962 |
| Rolling Woods CSA | - | 79,007 | 79,007 |
| Septic Tank Maintenance CSA | - | 632,328 | 632,328 |
| Freedom County Sanitation District | - | 346,128 | 346,128 |
| Davenport Sanitation District | - | 299,785 | 299,785 |
| Place de Mer CSA | - | 44,013 | 44,013 |
| Sand Dollar Beach CSA | - | 196,945 | 196,945 |
| Trestle Beach CSA | - | 33,170 | 33,170 |
| Summit West CSA | - | 18,924 | 18,924 |
| Graham Hill CSA | <u>-</u> | <u>333</u> | <u>333</u> |
| Total expenses | <u>345,387,571</u> | <u>11,778,568</u> | <u>357,166,139</u> |
| Change in net assets | (8,407,589) | 652,814 | (7,754,775) |
| Restated net assets, beginning | 82,773,722 | 44,270,417 | 127,044,139 |
| Prior period adjustment | <u>(760,746)</u> | <u>(2,997,792)</u> | <u>(3,758,538)</u> |
| Net assets, ending | <u>\$ 73,605,387</u> | <u>\$41,925,439</u> | <u>\$115,530,826</u> |

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Analysis of Changes in Net Assets

The County's net assets decreased by \$7,754,775 (exclusive of prior period adjustment) during the current fiscal year. These decreases are explained in the government and business-type activities discussion below.

Governmental activities. Governmental activities decreased the County's net assets by \$8,407,589, thereby accounting for 108% of the total decrease in net assets of the County. Key elements of this decrease are as follows:

- Utility Users Tax decrease of \$2,945,000 due to voter repeal on March 5, 2002.
- Capital Project expenditures of \$6,707,000 on the road pavement management program.

Business-type activities. Business-type activities increased the County's net assets by \$652,814.

FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

As noted earlier, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Types of governmental funds reported by the County include the General Fund, Special Revenue Funds, Debt Service Funds, and Capital Project Funds.

At June 30, 2002, the County's governmental funds reported combined ending fund balances of \$177,057,075, an increase of \$3,462,932 in comparison with the prior year. Approximately 68% or \$119,918,733 of the combined ending fund balances constitutes unreserved fund balance, which is available to meet the County's current and future needs. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has been committed: (1) to pay debt service \$11,020,544; (2) to fund fixed asset acquisition \$14,699,180; (3) to liquidate contractual commitments of the period \$26,491,422; (4) for a variety of other purposes \$4,927,196.

Revenues for governmental functions totaled approximately \$337,506,073 in fiscal year 2001-2002, which represents an increase of \$24,790,149 or 8% from fiscal year ended 2000-2001. Expenditures for governmental functions, totaling \$345,797,482 increased by \$39,026,314 or 13% from the fiscal year 2000-2001. In the fiscal year 2001-2002, expenses for governmental functions exceeded revenues by approximately \$8,291,409.

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The general fund is the primary operating fund of the County. At June 30, 2002, unreserved fund balance of the general fund was \$33,560,911 while total fund balance reached \$37,051,712. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 12% of total general fund expenditures of \$271,713,625, while total fund balance represents 14% of that same amount.

The following table presents the amount of revenues from various sources as well as increases or decreases from the prior year.

Revenues Classified by Source
Governmental Funds

| <u>Revenues by Source</u> | <u>FY 2002</u> | | <u>FY 2001</u> | | <u>Increase/(Decrease)</u> | |
|--------------------------------------|----------------------|-------------------|----------------------|-------------------|----------------------------|--------------------|
| | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Change</u> |
| Taxes | \$ 75,425,523 | 22.35% | \$ 75,704,048 | 24.22% | (\$ 278,525) | (0.37%) |
| Licenses | 7,557,113 | 2.23% | 7,412,751 | 2.37% | 144,362 | 1.95% |
| Fines, forfeitures and penalties | 4,692,668 | 1.39% | 4,474,401 | 1.43% | 218,267 | 4.88% |
| Use of money and property | 7,682,370 | 2.28% | 12,545,643 | 4.01% | (4,863,273) | (38.76%) |
| Aid from other governmental agencies | 188,342,183 | 55.80% | 162,612,762 | 52.00% | 25,729,421 | 15.82% |
| Charges for current services | 42,543,942 | 12.61% | 40,788,384 | 13.04% | 1,755,558 | 4.30% |
| Other revenues | <u>11,262,274</u> | <u>3.34%</u> | <u>9,177,935</u> | <u>2.93%</u> | <u>2,084,339</u> | <u>22.71%</u> |
| Total | <u>\$337,506,073</u> | <u>100.00%</u> | <u>\$312,715,924</u> | <u>100.00%</u> | <u>\$24,790,149</u> | <u>7.93%</u> |

The following provides an explanation of revenues by source that changed significantly from the prior year.

- Fines, forfeitures and penalties – the result of an audit adjustment to realign distributions amongst participating agencies.
- Use of money and property – a major decline in the reinvestment rates earned on the Treasurer's Pooled Investments. Rates dropped from 6.276% to 3.279% from 2000-01 to 2001-02. A decrease of 2.997%
- Aid from other governmental agencies – the major increases are from the following State and Federal revenue sources:
 - Motor Vehicle In-Lieu Taxes \$2.6 million
 - Child Support (both incentives and administrative) 3.7 million
 - Road Projects (both State & Federal) 6.0 million
 - Tobacco Tax Settlement .5 million
 - Proposition 172 Public Protection 1.3 million
 - Supplemental Law Enforcement Grants 1.0 million
 - Public Assistance (both State & Federal) 4.5 million
 - Health & Mental Health Assistance 2.6 million

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- Other revenues – the City of Santa Cruz purchased the County of Santa Cruz's financial interest in the homeless shelter for \$743,288 and the County of Santa Cruz received a fire insurance settlement of \$253,499. The remainder is contributions from other funds for the mold removal project at the new health services facility on the Emeline Street campus.

The following table presents expenditures by function compared to prior year amounts.

Expenditures by Function
Governmental Funds

| <u>Expenditures by Function</u> | <u>FY 2002</u> | | <u>FY 2001</u> | | <u>Increase/(Decrease)</u> | |
|--|----------------------|-------------------|----------------------|-------------------|----------------------------|--------------------|
| | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Change</u> |
| General government | \$ 22,228,087 | 6.43% | \$ 18,256,296 | 5.95% | \$ 3,971,791 | 21.76% |
| Public protection | 96,865,192 | 28.01% | 89,917,980 | 29.31% | 6,947,212 | 7.73% |
| Health and sanitation | 74,752,115 | 21.62% | 67,561,891 | 22.02% | 7,190,224 | 10.64% |
| Public assistance | 85,076,011 | 24.60% | 77,551,338 | 25.28% | 7,524,673 | 9.70% |
| Education | 3,067,150 | 0.89% | 3,102,318 | 1.01% | (35,168) | (1.13%) |
| Recreation and culture | 7,299,961 | 2.11% | 7,209,467 | 2.35% | 90,494 | 1.26% |
| Public ways and facilities | 31,089,554 | 8.99% | 22,845,848 | 7.45% | 8,243,706 | 36.08% |
| Capital outlay | 11,860,959 | 3.43% | 6,309,155 | 2.06% | 5,551,804 | 88.00% |
| Debt service-bond redemption | 4,352,757 | 1.26% | 4,642,318 | 1.51% | (289,561) | (6.24%) |
| Debt service-interest and fiscal charges | <u>9,205,696</u> | <u>2.66%</u> | <u>9,374,557</u> | <u>3.06%</u> | <u>(168,861)</u> | <u>(1.80%)</u> |
| Total | <u>\$345,797,482</u> | <u>100.00%</u> | <u>\$306,771,168</u> | <u>100.00%</u> | <u>\$39,026,314</u> | <u>12.72%</u> |

The following provides an explanation of expenditures by function that changed significantly from the prior year.

- General government – three major components included the cost associated with the March 2002 primary election (\$377,000), the increased costs associated with utilities and labor costs (\$259,000 and \$308,000 respectively) and a change in billing methodology affecting Intra-fund Charges in the County Counsel Office (\$1,270,000) increasing the net county cost accordingly.
- Public protection – increased expenditures associated with salaries and related operating expenditures for the Sheriff (\$2,763,000), Probation (\$1,302,000), Detention (\$988,000), and Family Support (\$1,885,000) departments.
- Health and sanitation – increased expenditures encompassed most program areas including: administration (\$298,000), clinics (\$333,000), public health (\$730,000), mental health (\$3,842,000), drug & alcohol (\$1,502,000), and adult Medicaid (\$372,000).
- Public assistance – increased expenditures related to the operations of the Human Resources Agency, and programmatic expenditures for adoptions, foster care, workforce training, and community programs

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- Public ways and facilities – the change reflects the expenditure of Federal Highway Bridge Reconstruction and Rehabilitation monies largely on the Brown Valley (\$1.4 million), Bargetto (\$.9 million), and Soquel (.5 million) bridges. It also reflects approximately \$8.2 million spent on redevelopment projects roads, drainage, and low-income housing.
- Capital outlay – the increase reflects the expenditure of \$6.7 million for the road pavement improvement program from funds appropriated in 2000-01 in the amount of \$7 million. An additional \$5 million was appropriated in 2001-02 and another \$1 million in 2002-03 from one-time revenue sources to improve the unincorporated area roadways
- Debt service interest and fiscal charges – the increase reflects the interest payments on the new bonds issued by the Redevelopment Agency during 2000-01 totaling \$1,559,000, and the cost of issuance of the 1990 and 2000 series A & B totaling \$1,728,000. The cost of issuance included \$780,000 for bond insurance and the remainder was for other issuance costs. The net present savings was estimated to total \$2.2 million net of the call premium of \$308,000 on the 1990 tax allocation bonds.

Other financing sources and uses are presented below to illustrate changes from the prior year:

Other Financing Sources (Uses)
Governmental Funds

| | <u>FY 2002</u> | | <u>FY 2001</u> | | <u>Increase/(Decrease)</u> | |
|---|---------------------|-------------------|---------------------|-------------------|----------------------------|--------------------|
| | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Total</u> | <u>Amount</u> | <u>% of Change</u> |
| Proceeds from sale of capital assets | \$ 6,097 | 0.05% | \$ 5,492 | 0.01% | \$ 605 | 11.02% |
| Proceeds from long-term debt | 11,748,244 | 99.95% | 38,751,407 | 74.74% | (27,003,163) | (69.68%) |
| Proceeds from refunding bonds | - | - % | 15,871,894 | 30.61% | (15,871,894) | (100.00%) |
| Payments to bond refunding escrow agent | - | - % | (15,385,448) | (29.67%) | 15,385,448 | (100.00%) |
| Operating transfers in | 52,856,283 | 449.67% | 59,074,853 | 113.93% | (6,218,570) | (10.53%) |
| Operating transfers out | (52,856,283) | (449.67%) | (47,267,197) | (91.16%) | (5,589,086) | 11.82% |
| Inception of lease purchase agreement | - | - % | 800,000 | 1.54% | (800,000) | (100.00%) |
| Total | \$11,754,341 | 100.00% | \$51,851,001 | 100.00% | (\$40,096,660) | (77.33%) |

The payment on long term debt reflects the refunding of the 1990 tax allocation bonds, and the proceeds from long term debt reflect the new 2000 tax allocation bond series A & B.

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The current year excess of revenues and other financing sources over expenditures and other financing uses is presented below:

Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds

| | Major Funds | | Nonmajor Funds | | | Total |
|---------------------------------------|----------------------|---------------------|----------------------------|-------------------------|------------------------------|----------------------|
| | General Fund | Redev Agency | Special Revenue Fund | Debt Service Fund | Capital Projects Funds | |
| Revenues | \$276,162,551 | \$16,891,953 | \$41,834,698 | \$ 392,548 | \$ 2,224,323 | \$337,506,073 |
| Expenditures | (271,713,625) | (7,040,853) | (47,092,396) | (8,089,649) | (11,860,959) | (345,797,482) |
| Net other financing sources (uses) | (12,385,191) | (7,880,339) | <u>16,330,022</u> | <u>7,748,471</u> | <u>7,941,378</u> | <u>11,754,341</u> |
| Net change in fund balances | (7,936,265) | 1,970,761 | 11,072,324 | 51,370 | (1,695,258) | 3,462,932 |
| Fund balances, beginning | <u>44,987,977</u> | <u>70,444,037</u> | <u>32,328,246</u> | <u>6,833,151</u> | <u>19,000,732</u> | <u>173,594,143</u> |
| Fund balances, ending | <u>\$ 37,051,712</u> | <u>\$72,414,798</u> | <u>\$43,400,570</u> | <u>\$6,884,521</u> | <u>\$17,305,474</u> | <u>\$177,057,075</u> |

The fund balance in the County's general fund decrease of \$7,936,265 during the fiscal year was explained above under the caption Analysis of Changes in Net Assets which shows the \$5 million operating transfer out to fund the road management improvement capital projects, and the loss of \$2.9 million due to the repeal of the Utility Users Tax.

Proprietary Funds

The County's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

The County Disposal Sites CSA had total net assets of \$30,047,842 at June 30, 2002 of which \$17,996,021 is unrestricted. The total increase in net assets for the County Disposal Sites CSA was \$965,622 discussed below.

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The following table shows the Enterprise Funds' actual revenues, expenses and results of operations for the current fiscal year:

| | <u>Major Fund</u> County Disposal <u>Sites CSA</u> | Nonmajor <u>Funds</u> | <u>Total</u> |
|---------------------------------------|--|--------------------------|-----------------------|
| Operating revenues | \$9,482,077 | \$1,869,873 | \$11,351,950 |
| Operating expenses | (<u>9,508,531</u>) | (<u>1,990,806</u>) | (<u>11,499,337</u>) |
| Operating loss | (26,454) | (120,933) | (147,387) |
| Net non-operating revenues (expenses) | <u>992,076</u> | <u>167,196</u> | <u>1,159,272</u> |
| Net income before contributions | 965,622 | 46,263 | 1,011,885 |
| Capital contributions | <u>-</u> | <u>6,524</u> | <u>6,524</u> |
| Change in net assets | <u>\$ 965,622</u> | <u>\$ 52,787</u> | <u>\$ 1,018,409</u> |

The net income before contributions of the enterprise funds of \$1,011,885 resulted primarily from a net income of \$965,622 for the County Disposal Sites CSA. The change in net assets for the County Disposal Sites CSA decreased by \$1,909,844 compared to the prior year's net income of \$2,875,466. This decrease reflects reduced gate fees due to the waste diversion program, construction slow-down and increased operating expenditures.

The internal service funds' activities attributable to the enterprise funds amounts to a decrease in net assets of \$365,595.

GENERAL FUND BUDGETARY HIGHLIGHTS

Differences between the original budget and the final amended budget resulted in a \$16,920,204 increase in appropriations and can be briefly summarized as follows:

- \$1.5 million to offset the cost of negotiated employee contracts for public safety personnel in the Sheriff's Office.
- \$4.0 million mid-year changes for expanded funding for Health Services Agency programs including homeless shelter health, Proposition 62 drug and alcohol treatment as alternatives to incarceration, and other programs.
- \$4.1 million mid-year changes for unanticipated revenue for various public assistance programs aid for families with dependent children, foster care, and child care.
- \$4.9 million of increased appropriation for transfers in and out largely to provide the resources to account for the full cost of extended police protection in the unincorporated area of the county (\$4.1 million).

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During the year, actual revenues were less than budgetary estimates by \$30,316,143. Majority of this negative variance amount, \$21,515,773, represents the negative variance of the operating transfers in from the other funds. Actual expenditures were less than budgetary estimates by \$39,725,310. This positive variance is mainly due to the \$11,486,611 of non-salary expenditure savings due to lower than budgeted public assistance payments and health care contract savings, plus \$9,261,019 of salaries and employee benefits savings due to a number of vacant positions during the fiscal year. Many of the funded vacant positions were cut from the 2002-03 budget to partially offset the repeal of the Utility Users Tax. The net effect of under-realization of revenues and under-utilization of appropriations resulted in a favorable variance of \$9,409,167, thus eliminating the need to draw upon existing fund balance.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The County's capital assets for its governmental and business-type activities as of June 30, 2002, totaled \$115,624,024 (net of accumulated depreciation). This investment in capital assets includes land, buildings and structures, and equipment. The increase in the County's investment in capital assets for the current period was \$2,796,504 or 1.46%.

Major capital asset events during the current fiscal year included the following:

- Buildings and structures increased by \$3,002,348, mostly for governmental activities of \$2,938,222 for building improvements to the County and Health Services buildings, and Detention facilities.
- Changes to buildings and structures for business-type activities were mainly due to the transfer of assets in the amount of \$2,757,625 from the Freedom Sanitation District to the City of Watsonville, and the reclassification of assets from Construction in Progress to Buildings and Structures in the amount of \$404,097 for the County Disposal CSA.
- Equipment for governmental activities increased by \$3,510,665 due mainly to various equipment purchases for general government in the amount of \$2,590,005 and the Internal Service Fund (ISF) Service Center in the amount of \$372,881. Retirements of assets from the Service Center and the Information Services (ISF) funds amounted to approximately \$604,000 and \$156,000 respectively.

For government-wide financial statement presentation, all depreciable capital assets were depreciated from acquisition date to the end of the current fiscal year. Fund financial statements record capital asset purchases as expenditures.

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

| | <u>Governmental</u> <u>Activities</u> | | <u>Business-type</u> <u>Activities</u> | | <u>Total</u> | | <u>Increase/</u> <u>(Decrease)</u> |
|--------------------------|--|-----------------------------------|---|-----------------------------------|----------------------|-----------------------------------|---------------------------------------|
| | <u>2002</u> | <u>2001</u> <u>As restated</u> | <u>2002</u> | <u>2001</u> <u>As restated</u> | <u>2002</u> | <u>2001</u> <u>As restated</u> | <u>Percent</u> <u>Of Change</u> |
| Land | \$ 31,780,653 | \$ 31,780,653 | \$ 1,858,849 | \$ 1,858,849 | \$ 33,639,502 | \$ 33,639,502 | - % |
| Buildings and structures | 86,306,678 | 83,304,330 | 23,940,259 | 26,293,787 | 110,246,937 | 109,598,117 | 0.59% |
| Equipment | <u>44,379,874</u> | <u>42,840,216</u> | <u>6,629,140</u> | <u>6,021,114</u> | <u>51,009,014</u> | <u>48,861,330</u> | 4.40% |
| Total | <u>\$162,467,205</u> | <u>\$157,925,199</u> | <u>\$32,428,248</u> | <u>\$34,173,750</u> | <u>\$194,895,453</u> | <u>\$192,098,949</u> | 1.46% |

The County's infrastructure assets are not recorded in the government-wide financial statements.

Additional information on the County's capital assets can be found in Note 5 on pages 65-66 of this report.

Long-term debt

At June 30, 2002, the County's long-term debt consisted of the following:

For the governmental activities, the County had total long-term debt outstanding of \$175,466,309 as compared to \$168,790,010 in the prior year (excluding compensated absence and estimated claims). This amount was comprised of \$33,595,912 of revenue bonds, \$26,550,000 of certificates of participation, California Health facilities financing authority debt of \$1,651,861, Redevelopment Agency Tax Allocation Bonds of \$111,070,000 loans payable of \$1,271,788, local assessment bonds of \$110,000 and Capital leases of \$1,216,748. During the year, retirement of debt amounted to \$5,366,605. Additions amounted to \$11,900,000.

For the business-type activities, the County had total long-term debt outstanding of \$2,697,946 as compared to \$3,309,409 in the prior year (excluding postclosure liability). This amount was comprised of \$2,612,455 of loans payable and \$85,491 of Capital Leases. During the year, retirement of debt amounted to \$611,463. There were no additions to long-term debt for business-type activities.

The component unit, Santa Cruz County Sanitation District, had total long-term debt outstanding of \$33,266,743 as compared to \$34,569,932 in the prior year (excluding discount). This amount was comprised of Revenue Bonds of \$4,340,000, Limited Obligation Improvement Bonds of \$1,205,000, Certificates of Participation of \$6,205,000 and loans payable of \$21,516,743. During the year, retirement of debt amounted to \$1,303,189. There were no additions to long-term debt for the component unit.

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The County's total debt increased by \$12,042,904 (or 7%) during the current fiscal year (excluding compensated absence, estimated claims, and postclosure liability). The key factor in this increase was an \$11,900,000 lease revenue bond issuance for construction and improvements to the County's Health Services buildings and acquisition of various equipment for the County's Departments of Public Works, Agricultural Commissioner, and County Counsel.

Additional information on the County's long-term debt can be found in Note 7 on pages 68-77 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

- The County financial position is presently in line with the budgetary parameters set by the Board of Supervisors and as amended for the 2002-2003 fiscal year. However, the General Fund's ending undesignated year end carry-over fund balance will be less than the prior year due to fewer vacant positions and the salary and employee benefit increases approved by the Board of Supervisors for the County's General Representation Group of Employees and Public Safety Employees.
- Real property assessment at January 1, 2002 showed a decrease of 1.7% from the prior year, slower property tax growth is expected in fiscal year 2002/2003.
- Sales tax revenue is expected to increase slightly due to continued consumer confidence caused by the slow economic recovery. However, our budget estimates were reduced by 1% for 2002-03 and we anticipate achieving that estimate for the fiscal year.
- The financial deficits of the State of California have shifted financial responsibilities to local agencies. The State has failed to reimburse counties for state mandated programs for the prior and current fiscal years without any promise of when or if these owed monies will ever be repaid. To track monies owed to the county by the state, accounts receivables have been established with offsetting reserves in the event that the State fails to carry out its obligations. At yearend \$2.3 million was designated.
- Substantial State budget cuts are anticipated next year. The County will address the effects of these budget cuts once the amounts are known.
- During the current fiscal year, unreserved fund balance in the general fund decreased to \$33,560,911. The County has appropriated the full amount for spending in the current fiscal year budget but expects to have about \$10-\$15 million balance remaining at year end for the 2003-04 fiscal year
- Meanwhile, the County is developing a proposed budget for the 2003-2004 fiscal year. Due to slow economic growth in revenues and projected increased labor costs, departments have been asked to submit budgets that reflect minor increases or no increase in the net cost to the county.
- For further discussion, please see the accompanying transmittal letter.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Auditor-Controller's Office, County of Santa Cruz, 701 Ocean Street, Room 100, Santa Cruz, CA 95060.