I. Summary of Significant Accounting Policies

A. The Reporting Entity

The County of San Diego (the "County"), is a political subdivision of the State of California (the "State") charged with general governmental powers and governed by an elected five-member Board of Supervisors (the "Board"). The County provides a full range of general government services including police protection, detention and correction, public assistance, health and sanitation, recreation, library, flood control, public ways and facilities, inactive waste management, airport management and general financial and administrative support.

As required by generally accepted accounting principles in the United States of America (GAAP), these financial statements present the County (the primary government) and its component units, entities for which the County is considered to be financially accountable. The component units discussed below are included in the County's reporting entity because of the significance of their operational or financial relationships with the County. Management applied the criteria of Governmental Accounting Standards Board (GASB) Statement No. 14, "The Financial Reporting Entity," and Statement No. 39, "Determining Whether Certain Organizations are Component Units - an amendment of GASB Statement No. 14," to determine whether the following component units should be reported as blended or discretely presented component units. Blended component units, although legally separate entities are, in substance, part of the County's operations. Data from these component units are combined with the data from the primary government. The discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the County.

1. Blended Component Units

Blended component units governed by the Board of Supervisors include the County of San Diego In-Home Support Services Public Authority (IHSS), the San Diego County Housing Authority, the San Diego County Redevelopment Agency, as well as various service areas and districts which provide specific services County-wide or to distinct geographic areas within the County. While each of these component units is legally separate from the County, the County is financially accountable for these entities. Financial accountability is demonstrated by the County Board of Supervisors acting as the governing board for each of these component units. Descriptions of these component units are as follows:

County of San Diego In-Home Supportive Services Public Authority (IHSS) - This authority was established to serve as the employer of record for the IHSS program which provides in-home assistance to low-income aged, blind, and disabled individuals enabling them to remain safely in their own homes and avoid institutionalization. The IHSS program is state-mandated. This fund is included as a *special revenue fund.*

San Diego County Housing Authority - This authority accounts for revenues and expenditures related to providing decent housing in a suitable environment for individuals who cannot afford standard private housing. Contracts with the U.S. Department of Housing and Urban Development provide the major funding sources. This fund is included as a *special revenue fund*.

San Diego County Redevelopment Agency - This agency was established to provide a method of eliminating slums and blighted areas, improving housing, expanding employment opportunities, and providing an environment for the social, economic and psychological growth, and well-being of all citizens of the County. This agency is included in the *debt service and capital projects funds*.

Air Pollution Control District - This district was established to provide for control of air pollution from motor vehicles and other sources in order to attain health-based air quality standards. Revenue sources include license and permit fees, fines, state and federal funds, charges to property owners and vehicle registration fees. This fund is included as a *special revenue fund*.

County Service Districts - These special districts were established to provide authorized services such as road, park, lighting maintenance, fire protection or ambulance service to specific areas in the county. They are financed by ad valorem property taxes in the area benefited or by special assessments levied on specific properties. These funds are included as *special revenue funds*.

Flood Control District - This district was established to account for revenues and expenditures related to providing flood control in the County. It is financed primarily by ad valorem property taxes and federal grants. This fund is included as a *special revenue fund*.

Lighting Maintenance District - This district was established to provide street and road lighting services to specified areas of the County. Revenue sources include ad valorem taxes, benefit fees, state funding and charges to property owners. This fund is included as a *special revenue fund*.

Sanitation Districts - These districts are used to account for the activities of all individual sanitation districts governed by the County Board of Supervisors. They are included as *enterprise funds*.

Blended component units governed by Boards other than the Board of Supervisors include the San Diego County Capital Asset Leasing Corporation, the San Diego County Tobacco Asset Securitization Corporation, the Tobacco Securitization Joint Powers Authority of Southern California and the San Diego County Employee Retirement Association (SDCERA). Because of their relationship with the County and the nature of their operations, the first three of these component units are, in substance, part of the County's operations and, accordingly, the activities of these component units are combined (blended) with the activities of the County for purposes of reporting in the accompanying basic financial statements. The basis for blending these component units is that the governing bodies are substantially the same as the County Board of Supervisors. SDCERA is legally separate from the County, and although it is reported as a Pension Trust Fund, it benefits the County almost exclusively by providing services to the County's employees.

Descriptions of these component units are as follows:

San Diego County Capital Asset Leasing Corporation (SANCAL) - This corporation was established to finance the acquisition of County buildings and equipment. It is a nonprofit corporation governed by a five-member Board of Directors, which is appointed by the County Board of Supervisors. This corporation is included in the *special revenue, debt service* and *capital projects funds*.

The San Diego County Tobacco Asset Securitization Corporation (Corporation) - This is a separate legal nonprofit public benefit corporation created under the California Nonprofit Public Benefit Corporation Law. It was established to purchase tobacco settlement payments allocated to the County from the State of California, pursuant to the Master Settlement Agreement concluded on November 23, 1998 between the major tobacco companies and 46 states (including California), the District of Columbia and four U.S. Territories. The Corporation is governed by the Board of Directors consisting of three members, two of which are employees of the County of San Diego and one independent director who is not an employee of the County. This fund is included as a *special revenue fund*.

The Tobacco Securitization Joint Powers

Authority of Southern California (TSJPA) - This is a separate legal public entity created by a Joint Exercise of Powers Agreement by and between the County of San Diego and the County of Sacramento pursuant to the Government Code of the State of California. The Authority's purpose is to finance a loan via the sale of bonds to the San Diego County Tobacco Asset Securitization Corporation which in turn uses the loan proceeds to purchase the County's future tobacco settlement revenues under the Purchase and Sale Agreement. The Authority is administered by the Board of Directors consisting of three members, two members who are appointed by the County of San Diego Board of Supervisors and the third member is appointed by the Sacramento County Board of Supervisors. This fund is included as a *special revenue fund*.

The San Diego County Employees Retirement Association - SDCERA is a multiple-employer public retirement system organized under the County Employees Retirement Act of 1937 and provides retirement, disability and death benefits for plan members and beneficiaries. The County is the major participant and contributes 92.6 percent of total employer contributions. SDCERA is governed by a nine-member board which includes the County Treasurer-Tax Collector, four members appointed by the Board of Supervisors and four members elected by the SDCERA membership. The activity of SDCERA is reported within the *pension trust fund* and included in the *fiduciary funds*.

2. Discretely Presented Component Unit

The following component unit is discretely presented because its Board is not substantively the same as the County's Board and it does not provide services entirely or almost entirely to the County.

First 5 Commission of San Diego (Commission) - The Commission was established by the County as a separate legal entity to administer the County's share of tobacco taxes levied by the State pursuant to Proposition 10. Its purpose is to develop, adopt, promote and implement early childhood development programs in the County. The Commission is a separate legal entity, and the County appoints a voting majority of the Commission's board. The County is able to impose its will on the Commission, due to its ability to change the appointees. The two boards (County and Commission) are not substantively the same and the Commission does not provide services entirely or almost entirely to the County, but to the citizens instead.

3. Additional Detailed Financial Information and/or Financial Reports

Additional detailed information and/or separately issued financial reports of the County's component units may be obtained from the County Auditor and Controller's Office located at 1600 Pacific Highway, Room 166, San Diego, California 92101. Also, complete financial statements for SDCERA may be obtained from the San Diego County Employees Retirement Association, 2275 Rio Bonito Way, Suite 200, San Diego, CA 92108-1685.

B. Government-Wide and Fund Financial Statements

1. Government-Wide Financial Statements

The government-wide financial statements consist of the statement of net assets and the statement of activities and report information on all of the nonfiduciary activities of the primary government and its component units. As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. However, interfund services provided and used are not eliminated in the process of consolidation. All internal balances in the statement of net assets have been eliminated, with the exception of those representing balances between the governmental activities and the business-type activities, which are presented as internal balances and eliminated in the total government column. The statement of activities presents function revenue and expenses of governmental activities and business-type activities. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. In the statement of activities, internal service funds' revenue and expenses related to interfund services have been eliminated. Revenue and expenses related to services provided to external customers have not been eliminated and are presented within governmental activities.

The 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, public ways and facilities, public assistance, health and sanitation, recreation and cultural, and education activities. The business type activities of the County include sanitation, wastewater and airport.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

2. Fund Financial Statements

Separate fund financial statements are provided for governmental funds, proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. The focus of governmental and proprietary fund financial statements is on major funds. The financial information of each major fund is shown in a separate column in the fund financial statements, with the data for all nonmajor governmental funds aggregated into one single column on the Governmental Funds Balance Sheet, and with data for all nonmajor enterprise funds aggregated into one single column on the Statement of Net Assets Proprietary Funds.

The County reports the following major governmental funds:

The *General Fund* is the County's primary operating fund. It accounts for all financial resources of the County except those required to be accounted for in another fund. Revenues are primarily derived from taxes; licenses, permits and franchises; fines, forfeitures and penalties; use of money and property; intergovernmental revenues; charges for services; and other revenues. Expenditures are expended for functions of general government, public protection, public ways and facilities, health and sanitation, public assistance, education, and recreation and cultural. Expenditures also include capital outlay and debt service.

The *Tobacco Securitization Special Revenue Fund* accounts for tobacco settlement payments allocated to the County from the State of California, pursuant to the Master Settlement Agreement concluded on November 23, 1998 between the major tobacco companies and 46 states (including California), the District of Columbia and four U.S. Territories.

The County reports the following additional funds and fund types:

Enterprise Funds account for airport, sanitation district and wastewater management activities, including operations and maintenance, sewage collection and treatment services.

Internal Service Funds account for the financing of public works and communications equipment; the financing of materials and supplies (purchasing); for start up services for new and existing county service districts; for the County's uninsured risk management activities; the financing of fleet services; for facilities management activities; for the financing of information technology services; and for the financing of clothing and personal sundry items for persons institutionalized at various county facilities. Additionally, mail services are included within the facilities function, and printing and record storage services are included in the purchasing function. The goods or services provided by one County department to other County departments are on a cost reimbursement basis.

The following *fiduciary funds* account for resources that are held by the County as a trustee or agent for outside parties and cannot be used to support the County's programs.

The *Pension Trust Fund* accounts for the activities of SDCERA. This fund is under the control of the Board of Retirement and is governed by the rules and regulations of the County Employees Retirement Act of 1937. The fund accumulates employer and employee contributions and earnings from the fund's investments. Disbursements are made from the fund for retirements, disability and death benefits and refunds and administrative costs. This fund includes all assets of the retirement system.

The *Investment Trust Fund* accounts for the external portion of the County Treasurer's investment pool. This fund consists of school districts, special districts and funds held for other governments.

Agency Funds are custodial in nature and do not involve measurement of results of operations and account for assets held by the County as an agent for various local governments, organizations and individuals. Included are funds for child support payments; payroll taxes; public administrator and public guardian accounts; and apportioned taxes for other local governments.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide, proprietary, pension and investment trust fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Agency Funds are reported using the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Nonexchange transactions, in which the County gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes and sales taxes, grants, entitlements, and donations. On the accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from sales taxes is recognized when the underlying transactions take place. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligible requirements have been satisfied.

Governmental Funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Sales taxes, interest, state and federal grants, and charges for services are accrued when their receipt occurs within 180 days following the end of the fiscal year. Property taxes are accrued if they are collectible within 60 days after the end of the accounting period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, claims, and judgments, are recorded only when payment is due. General capital assets acquisitions and general principal payments are reported as expenditures in governmental funds. Proceeds of general long-term debt and capital leases are reported as other financing sources.

Proprietary Funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the County's enterprise funds and internal service funds are charges to customers for services. Operating expenses for enterprise funds and internal service funds include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

For *business-type activities*, the County has elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board, or any Accounting Research Bulletins issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The County has elected to not apply the FASB standards issued subsequent to November 30, 1989. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental users.

When both *restricted and unrestricted resources* are available for use, it is the County's policy to use restricted resources first, then unrestricted resources as they are needed.

Fiduciary Funds include all *Trust and Agency Funds*, which account for assets held by the County as a trustee or as an agent for individuals or other government units.

D. Assets, Liabilities, and Net Assets or Fund Balance

1. Deposits and Investments

The County follows the practice of pooling cash and investments of all funds with the County Treasurer-Tax Collector's *Investment Pool (Pool)*, except for certain restricted funds which are generally held by outside custodians and classified as "cash with fiscal agent" or investments on the accompanying financial statements. The individual funds' portions of the Pool's fair value are presented as "equity in pooled cash and investments." For purposes of reporting cash flows, equity in pooled cash and investments, collections in transit and imprest cash are considered cash equivalents. Earnings on investments are distributed to Pool participants and are calculated using the accrual basis of accounting. The net realized earnings on investments are apportioned to the Pool participants quarterly, based on the participant's average daily balances. A separately issued comprehensive annual financial report of the San Diego County Investment Pool can be accessed at http://www.sdtreastax.com/mcf_afreports.html.

The *Pool's* investments are reported at fair value at June 30, 2006 based on market prices. Securities that are traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

The County Employees Retirement Act of 1937 (Law) grants exclusive control to the Board of Retirement over the investment of SDCERA's investment portfolio. The Law allows for the Board to invest, or delegate the authority to invest, the investment portfolio through the purchase, holding, or sale of any form or type of investment, financial instrument or financial transaction when prudent in the informed opinion of the Board.

The *Pension Trust Fund's* cash and short-term investments consist of cash and securities with fiscal agents and deposits held in a pooled account with the County. All participants in the pool proportionately share earnings and losses. Short-term investments consist of cash held in money market accounts and securities readily convertible to cash. Cash equivalents and securities for swaps and futures consist of money market securities and collective short-term investments with original maturities of three months or less.

Investments are reported at fair value at June 30, 2006 in the Pension Trust Fund based upon closing sale prices reported on recognized securities exchanges on the last business day of the period. For listed securities having no sales reported and for unlisted securities, fair value is based upon last reported bid prices. All purchases and sales of investments are accounted for on a trade-date basis, and dividends declared but not received are accrued on the ex-dividend date. Realized and unrealized gains or losses of securities are determined on the basis of average cost. Real estate investments are reported at estimated fair value, which has been determined by appraisals performed by independent real estate advisors approximately every three years.

2. Receivables and Payables

Activity between funds that are representative of lending and borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

All property taxes and accounts receivable are shown net of an allowance for uncollectibles.

The County collects property taxes on behalf of all property tax receiving agencies in the County. Property tax receiving agencies include the school districts, cities, community redevelopment agencies, independently governed special districts (not governed by the County Board of Supervisors), special districts governed by the County Board of Supervisors, and the other County funds.

Property taxes are levied on July 1 each fiscal year on taxable real and personal property, which is situated in the County as of the preceding January 1 lien date. However, upon a change in ownership of property or completion of new construction, State law requires an accelerated recognition and taxation of changes in real property assessed valuation. For assessment and collection purposes, property is classified either as "secured" or "unsecured" and is listed accordingly on separate parts of the assessment roll. The "secured roll" is that part of the assessment roll containing locally assessed and State assessed property secured by a lien, which is sufficient, in the opinion of the assessor, to secure payment of the taxes. Other property is assessed on the "unsecured roll."

Property taxes on the secured roll are payable in two installments, due November 1 and February 1. If unpaid, such taxes become delinquent after 5:00 p.m. on December 10 and April 10, respectively, and a ten percent penalty attaches. Property on the secured roll with unpaid delinquent taxes is declared tax-defaulted after 5:00 p.m. on June 30th. Such property may thereafter be redeemed by payment of the delinquent taxes, the ten percent delinquency penalty, a ten dollar cost, a fifteen dollar per parcel redemption fee (from which the State receives five dollars), and a redemption penalty of one and one-half percent per month starting July 1 and continuing until the end of redemption collectively, the "Redemption Amount". If taxes remain unpaid after five years on the default roll, the property becomes subject to tax sale by the County Treasurer-Tax Collector.

Property taxes on the unsecured roll are due as of the January 1 lien date and become delinquent, if unpaid, on August 31. A ten percent penalty attaches to delinquent taxes on property on the unsecured roll and an additional penalty of one and one-half percent per month begins to accrue on November 1.

Property tax collections are apportioned (disbursed) to the tax receiving agencies periodically from the tax unapportioned funds based on various factors including statutory requirements, tax delinquency dates and the type of property tax roll unapportioned fund (secured, unsecured, supplemental, delinquent secured, delinquent unsecured, delinquent supplemental, homeowners' property tax subvention, or public utility).

Property tax revenues are recognized in the fiscal year for which they are levied, provided they are due within the fiscal year and collected within 60 days after the fiscal year end. Property tax revenues are also recognized for unsecured and supplemental property taxes that are due at year end, and are collected within 60 days after the fiscal year end, but will not be apportioned until the next fiscal year due to the timing of the tax apportionment schedule. The County's portion of the unapportioned taxes at June 30, 2006 is allocated to and recorded in the corresponding funds for reporting purposes.

The County maintains records of disputed property taxes, such as those properties for which the values have been appealed to the local Assessment Appeals Boards. Upon final disposition of the appeals and disputes, the amounts are either refunded to taxpayers or the tax bills are corrected. As of June 30, 2006, tax refunds and assessed value tax roll corrections resulting from property tax appeals and other disputes represented approximately 0.78 percent of the combined beginning secured and unsecured property tax roll charge.

Beginning in fiscal year 2005, a sales tax-property tax swap known as the "triple flip" was instituted. The triple flip local government package was part of Proposition 57, a State ballot measure approved by the voters in March 2004. Proposition 57 suspended the one-quarter cent portion of the sales tax dedicated to local governments and replaced it with property taxes (the "Countywide Adjustment Amount") equal to the lost sales tax revenue.

In addition, legislation adopted as part of the State's fiscal year 2005 budget process and Proposition 1A, approved by voters on November 2, 2004, permanently reduced the vehicle license fees (VLF) from two percent to 0.65 percent, swapped county and city VLF revenues for property taxes, equal to the difference between the VLF rate of two percent and 0.65 percent with a revenue-neutral impact, provided for a two-year shift of property taxes from counties, cities, redevelopment agencies, and special districts to school districts to partially reduce the State's General Fund deficit, in the total Statewide amount of $1.3 billion for each of fiscal years 2005 and 2006 and established new Constitutional restrictions on the State's ability to impose unfunded mandates and limits the State's ability to reduce County revenues in the future.

As established by the *Teeter Plan*, the Auditor and Controller allocates to the County and other agencies 100% of the secured property taxes billed but not yet collected by the County. In return, as the delinquent property taxes and associated penalties and interest are collected, the County retains such amounts in a separate fund. To the extent that fund's tax loss reserves are higher than required, transfers may be made to benefit the County's General Fund.

The tax loss reserve requirement for fiscal year 2006 was $10.281 million.

3. County Leased Property

The County leases real property to the private sector and other governmental agencies. In the government-wide and proprietary funds financial statements, non-cancelable and cancelable leases are reported in the applicable governmental activities or proprietary funds' statement of net assets.

4. Inventories and Prepaid Items

Inventories, which consist of expendable supplies, are stated at average cost. They are accounted for as expenditures at the time of purchase and reported in the balance sheet of the General Fund and the Other Governmental Funds as an asset with an offsetting reserve. Proprietary fund types are carried at average cost and are expended when consumed. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements. The inventories and prepaid items recorded in the governmental funds do not reflect current appropriable resources and thus, an equivalent portion of fund balance is reserved.

5. Deferred Charges

Bond issuance costs are deferred and amortized over the life of the bonds using the straight-line method. In the government-wide financial statements, deferred charges are reported as assets in the governmental activities.

6. Restricted Cash and Investments

Debt covenants require resources to be set aside to repay principal and interest thereon for tax and revenue anticipation notes, pension obligation bonds and SANCAL certificates of participation as restricted assets. Additionally, Tobacco Securitization Special Revenue Fund resources have been restricted and set aside to fund new and existing programs.

7. Capital Assets

Capital assets are defined as assets of a long-term character that are intended to be held or used in operations, such as land, buildings and improvements, equipment, and infrastructure. Infrastructure assets include roads, bridges, flood channels, street lights, signals, and sewers.

Capital assets are recorded at *historical cost* if purchased or constructed. Donated capital assets are recorded at *estimated fair market value* at the date of donation. Capital assets with an original unit cost equal to or greater than the County's *capitalization threshold* shown below are reported in the applicable *governmental* or *business-type activities* columns in the government-wide financial statements.

Table 1

Capitalization Thresholds		
Structures and improvements	$	50
Infrastructure (permanent road divisions, county service areas, sanitation and special districts)	$	25
Infrastructure (all others)	$	50
Equipment	$	5

Depreciation is charged over the capital assets' estimated useful lives using the *straight-line method* for proprietary and governmental fund types. Governmental fund type depreciation is only shown in the statement of activities. Proprietary fund type depreciation is shown both in the fund statements and the statement of activities. The estimated useful lives are shown in **Table 2** below:

Table 2

Estimated Useful Lives	
Structures and improvements	50 years
Infrastructure	10-50 years
Equipment	5-20 years

8. Deferred and Unearned Revenue

Under both the accrual and modified accrual basis of accounting revenue may be recognized only when earned. Therefore, the government-wide statement of net assets as well as governmental and enterprise funds defer revenue recognition in connection with resources that have been received as of year-end, but not yet earned. In the government-wide statement of net assets deferred revenue represents unearned revenue. Assets recognized in connection with a transaction before the earnings process is complete are offset by a corresponding liability for both deferred and unearned revenue. Under the modified accrual basis it is not enough that revenue has been earned if it is to be recognized in the current period. Revenue must also be susceptible to accrual (i.e. measurable and available to finance expenditures of the current period). Governmental funds report deferred revenues in connection with receivables for revenues not considered available to liquidate liabilities of the current period.

9. Lease Obligations

The County leases various assets under both *operating* and *capital* lease agreements. In the government-wide and proprietary funds financial statements, capital lease and operating lease obligations are reported as liabilities in the applicable governmental activities or proprietary funds statement of net assets.

10. Long-term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond and certificates of participation premiums discounts, deferred amounts on refundings, as well as issuance costs discussed above, are *deferred* and *amortized* over the life of the bonds and certificates of participation using the *straight-line method*. Bonds and certificates of participation payable are reported net of the applicable premium, discount, or deferred amount on refunding. In the fund financial statements, governmental fund types recognize bond and certificates of participation premiums and discounts, as well as issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

11. Employee Compensated Absences

The County's policy is to permit employees to accumulate *earned* but *unused* vacation, compensatory time, holiday and sick pay benefits. All vacation pay and a certain portion of compensatory and sick pay for specified employee classes is accrued when incurred in the government-wide and proprietary funds financial statements. In the governmental funds, only those amounts that are due and payable at year-end are accrued. Except for specified employee classes, there is no liability for *unpaid accumulated* sick leave since the County does not cash out unused sick leave when employees separate from service with the County. However, employees eligible for retirement benefits that meet minimum balance requirements may apply unused sick leave toward determining their length of service for purposes of determining their retirement benefits.

Amounts recorded as accumulated leave benefits include an amount representing salary-related payments such as the employer's share of Social Security and Medicare taxes associated with payments made for such compensated absences. Accumulated leave benefits including vacation, sick leave, and compensatory time worked in the amount of approximately $78.4 million for the governmental activities as of June 30, 2006, is recorded in the statement of net assets. These amounts would not be expected to be liquidated from expendable available financial resources but would be expected to be liquidated in future years as employees elect to use these benefits as prescribed by Civil Service rules and regulations.

12. Termination Benefits

Effective December 2000, County employees in the unclassified service may receive 50% of the cash value of all or a portion of their sick leave balances upon termination or retirement. The cash value of these benefits was $6.4 million at June 30, 2006. This liability has been recorded in the current and long-term portion of compensatable absences in the appropriate proprietary funds and the statement of net assets. All County employees who have completed at least five years of continuous service in the County retirement system, and have a sick leave balance of at least one hundred hours, may convert, at retirement, all or a portion of their sick leave balance to retirement service credits on a hour-for-hour basis. The impact of the conversion of sick leave balances to retirement service credits on the County's actuarial accrued liability, as part of its defined benefit pension plan, is not estimatable, however, contribution requirements as determined in the actuarial valuation as of June 30, 2006 include assumptions regarding employee terminations, retirement, death, etc.

13. Fund Balance

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

14. Net Assets Invested in Capital Assets, Net of Related Debt

This amount is derived by subtracting the outstanding debts, (adjusted by any unamortized deferred charges (costs of issuances), premiums, discounts, deferred amounts on refunding, and unspent proceeds related to debt), incurred by the County to buy or construct capital assets shown in the statement of net assets. Capital assets cannot readily be sold and converted to cash.

15. Restricted Net Assets

Restricted net assets arise when restrictions on the use of net assets are externally imposed by a creditor, (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. The government-wide statement of net assets reports $277.239 million of restricted net assets, of which $13.215 million is restricted by enabling legislation.

16. Unrestricted Net Assets

These assets are resources of the County that can be used for any purpose, though they may not necessarily be liquid. In addition, assets in a restricted fund that exceed the amounts required to be restricted by external parties or enabling legislation are reported as unrestricted net assets.

17. Indirect Costs

Expenditures and expenses for functional activities include County indirect costs that are allocated to benefiting departments under the County's Fiscal Year 2005-2006 *County-wide Cost Allocation Plan* which was prepared in accordance with the Federal Office of Management and Budget Circular A-87.

18. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and accompanying notes. Actual results could differ from those estimates. Where significant estimates have been made in preparing these financial statements, they are described in the applicable footnotes.

(Amounts Expressed in Thousands Unless Otherwise Noted)

II. Reconciliation of Government-Wide and Fund Financial Statements

A. Balance Sheet/Net Assets

Explanations of certain differences between the governmental funds balance sheet and the government-wide statement of net assets are detailed below:

Table 3

Governmental Fund Balance Sheet/Government-Wide Statement of Net Assets Reconciliation	
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of this $2,245,044 difference are as follows:	
Bonds, notes and loans payable	$ 2,450,346
Less: Unaccreted appreciation - capital appreciation bonds	(251,947)
Less: Unamortized deferred amounts on refundings (to be amortized as interest expense)	(48,583)
Less: Unamortized issuance discounts (to be amortized as interest expense)	(22,602)
Less: Unamortized issuance costs (to be amortized over the life of the debt)	(21,909)
Unamortized issuance premiums	7,257
Capital lease obligations (excluding Internal Service Funds)	31,894
Compensated absences (excluding Internal Service Funds)	76,141
Landfill closure and - San Marcos landfill	24,447
Net adjustment to reduce fund balance - total governmental funds to arrive at net assets - governmental activities	$ 2,245,044
Internal Service Funds are used by management to charge the costs of fleet management and management information systems to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. The details of this $82,512 difference are as follows:	
Net assets of the internal service funds	$ 83,101
Less: Internal payable representing charges in excess of cost to business-type activities - prior years	(501)
Less: Internal payable representing charges in excess of cost to business-type activities - current year	(88)
Net adjustment to increase fund balance - total governmental funds to arrive at net assets - governmental activities	$ 82,512

B. Statement of Revenues, Expenditures and Changes in Fund Balance/Statement of Activities

Explanations of certain differences between the governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities are detailed in **Table 4** on the following page.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 4

Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-Wide Statement of Activities Reconciliation		
Governmental Funds report capital outlays as expenditures. However, in the statement of activities the costs of those assets is allocated over their estimated useful lives and reported as depreciation expense. The details of this $23,714 difference are as follows:		
Capital outlay	$	109,897
Depreciation expense		(86,183)
Net adjustment to increase net changes in fund balances - total governmental funds to arrive at changes in net assets - governmental activities	$	23,714
The net effect of various miscellaneous transactions involving capital assets (i.e., sales, trade-ins, and donations) is to increase net assets.The details of this $7,989 difference are the following:		
The proceeds from the sale of capital assets provide current financial resources but have no effect on net assets	$	(12,355)
The gain on the disposal of capital assets does not affect current financial but increase net assets		6,142
Donations of assets to the County do not provide current financial resources but resources increase net assets		14,202
Net adjustment to increase net changes in fund balances - total governmental funds to arrive at changes in net assets - governmental activities	$	7,989
The issuance of long-term debt (e.g.bonds, notes, and loans) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance cost, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. The details of this $50,797 difference are as follows:		
Debt issued or incurred:		
Face value of bonds issued	$	166,611
Refunding certificates of participation issued		28,210
Refunding bonds issued		433,020
Plus: premiums		1,308
Less: costs of issuances		(6,172)
Less: discounts		(20,501)
Principal repayments		(57,245)
Capital lease payments		(2,720)
Debt service payment to refunded bond escrow agent		(24,256)
Payment to refunded bond escrow agent from proceeds		(467,458)
Net adjustment to decrease net changes in fund balances - total governmental funds to arrive at changes in net assets - governmental activities	$	50,797
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. The details of this $21,699 difference are as follows:		
Compensated absences	$	1,712
Accrued interest		481
Accrection of capital appreciation bonds		7,395
Amortization of premium		(82)
Amortization of deferred amounts on refundings		(7,621)
Amortization of issuance costs		12,861
Amortization of discounts		6,953
Net adjustment to decrease net changes in fund balances - total governmental funds to arrive at changes in net assets - governmental activities	$	21,699
Internal service funds are used by management to charge the costs of information technology, vehicle operations and maintenance, risk management and insurance, and communication services funds to individual funds. The net revenue of certain activities of internal service funds is reported with governmental activities. The details of this $(20,392) difference are as follows:		
Change in net assets of the internal service funds	$	(20,304)
Less: Loss from charges to business activities		(88)
Net adjustment to decrease net changes in fund balances - total governmental funds to arrive at changes in net assets - governmental activities	$	(20,392)

(Amounts Expressed in Thousands Unless Otherwise Noted)

III. Stewardship, Compliance and Accountability

A. Fund Deficits

The funds in **Table 5** below had accumulated deficits at June 30, 2006.

The deficit in the Risk Financing Internal Service fund resulted from the accrual of known and projected general claim liabilities based on actuarial studies. The deficit increased $16 million from the previous fiscal year due to a reestimation of projected case liabilities and increased costs associated with general claim case development. The County intends to reduce the deficits through increased premium rate charges to County departments.

The deficit within the Facilities Management Internal Service fund was due to the use of loan proceeds for expenses incurred for maintenance cost for energy conservation equipment. The $2.5 million increase in the deficit from the previous year resulted due to the aforementioned loan liability and an operating loss. This deficit will be reduced through increased department fees and/or a capital contribution from the General Fund.

Table 5

Fund Deficits - Various Funds	
Internal Service Funds:	
Risk Financing	$ 39,040
Facilities Management	7,057

IV. Detailed Notes on all Funds

Note: Tables 6 through 22 which are referenced in Note IV-A-1through 12 are located at the end of the note.

A. Deposits and Investments

Please refer to **Table 6** for a reconciliation of deposits and investments as reported in the basic financial statements and the information discussed in Notes IV-A 1 through 4.

1. San Diego County Investment Pool

The *San Diego County Investment Pool (the Pool)* is a local government Investment Pool with approximately $4.0 billion in assets as of June 30, 2006. It is headed by the Treasurer-Tax Collector, an elective office that is responsible for tax collection, banking, investment, disbursement and accountability of public funds. The San Diego County Investment Pool is managed by the County Treasurer's Office on behalf of the Pool participants, which include the County, local school districts, local community colleges and other districts and agencies. The local school districts are required by State statutes to deposit their funds with the County of San Diego. *"Mandatory"* participants in the Pool comprise the majority of the Pool's assets, approximately *98%*. All participants comply with the same requirements per the Pool Investment Policy.

The San Diego County Investment Pool operates under the prudent person standard. Specifically, California Government Code Sections 27000.1-27000.5, 27130-27137, and 53600-53686, authorize the Treasurer to invest funds in permissible types of investments or financial instruments. These include government obligation securities, commercial paper, medium-term notes, asset-backed securities, negotiable certificates of deposit, repurchase and reverse repurchase agreements and money market mutual funds. The Pool's *investment objectives* are to safeguard principal, meet the liquidity needs of the County and pool participants, and return an acceptable yield within the parameters of prudent risk management.

Pursuant to Sections 27130-27137 of the California Government Code, the Board of Supervisors has established the Treasurer's Oversight Committee (TOC) that monitors and reviews the Pool's investment policy. The TOC consists of members appointed from the districts or offices that they represent, and up to five members of the public, having expertise in, or an academic background in public finance. This Committee requires a financial audit to be conducted annually on a fiscal year basis, which includes limited tests of compliance with laws and regulations. The San Diego County Investment Pool is not registered with the Securities and Exchange Commission (SEC) as an investment company. The Pool does not have any legally binding guarantees of share values.

Earnings on investments are distributed to Pool participants and are calculated using the accrual basis of accounting. Section 27013 of the California Government Code authorizes the Treasurer's Office and Auditor and Controller's Office to deduct administrative fees related to investments. The net realized earnings on investments are apportioned to the Pool participants quarterly, based on the participants average daily balances.

2. Cash and Investments Outside of the Pool

a. Cash and Investments with Fiscal Agents

Cash with Fiscal Agents totaled $241.0 million on deposit with trustees for the General Fund, Tobacco Securitization Joint Special Revenue Fund, Air Pollution Special Revenue Fund, SANCAL Special Revenue Fund, Housing Authority Special Revenue Fund, Pension Obligation Bond Debt Service Fund, SANCAL Debt Service Fund, Redevelopment Agency Debt Service Fund, SANCAL Capital Projects Fund, and Other Agency Funds.

Investments with Fiscal Agents totaled approximately $874.3 million with Trustees. These amounts are accounted for in the General Fund, Tobacco Securitization Special Revenue Fund, Inactive Wastesites Fund, Pension Obligation Bonds Debt Service Fund and SANCAL Debt Service Fund.

b. Pension Trust Fund

SDCERA had *investments* of approximately $7.9 billion as of June 30, 2006. Investments are reported at fair value upon closing sale prices reported on recognized securities exchanges on the last business day of the period. For listed securities having no sales reported or for unlisted securities, fair value is based upon last reported bid prices. All purchases and sales of investments are accounted for on a trade-date basis, and dividends declared but not received are accrued on the ex-dividend date. Realized and unrealized gains or losses of securities are determined on the basis of average costs. Real estate investments consist of real estate equities primarily in office, industrial, retail and residential properties with 96.5% in the United States and 3.5% International.

SDCERA had *cash and cash equivalents with fiscal agents* totaling $157.9 million. Cash and short-term investments consist of cash and securities with fiscal agents. Short-term investments consist of cash held in money market accounts and securities readily convertible to cash. Cash equivalents and securities for swaps and futures consist of money market securities and collective short-term investments with original maturities of three months or less.

In addition to the above, SDCERA utilizes a diverse group of derivative instruments across the total fund, including swaps, options, forwards and a variety of futures contracts. Please refer to IV-A-12 (SDCERA Derivative Financial Instruments).

C. First 5 Commission of San Diego

The Commission had *investments* of approximately $185 million as of June 30, 2006. Of this amount $19.1 million was invested in the County Pool and $165.9 million was invested outside the County Pool. The Commissions investments are valued at fair value. Interest earned on pooled funds is allocated and credited to these funds quarterly. Interest on investments that are outside the County pool are recognized when earned (i.e. coupon payments on bonds). The investments of the commission are governed by California Government Code Section 53601.

3. Deposits

County Investment Pool - At year-end the carrying amount of the County's demand deposits was $19.901 million, while the related bank balance with various financial institutions consisted of $14.857 million in demand deposits and $1.691 million in insured time deposits. Of the total bank balance amount, $1.891 million was covered by federal deposit insurance and $14.657 million was collateralized with securities held by the pledging financial institution.

Cash and Investments with Fiscal Agents - At year-end the carrying amount of the County's demand deposits was $83.085 million, while the related bank balance with various financial institutions consisted of $86.033 million in demand deposits. Of the total bank balance amount, $.806 million was covered by federal deposit insurance and $13.212 million was collateralized with securities held by the pledging financial institution and the remaining $72.015 million was uncollateralized.

SDCERA Investment Portfolio - At year end the carrying amount of SDCERA's money market accounts and securities readily convertible to cash was $157.940 million.

First 5 Commission of San Diego - At year end the carrying amount of the First 5 Commission's investments with fiscal agent was $165.930 million.

4. Investments

Please see **Table 6** and refer to the information shown on **Tables 8 through 22** concerning investments in *the County Pool;* with *Fiscal Agents; the First 5 Commission of San Diego (Commission);* and the *Pension Trust Fund, (SDCERA).*

5. Deposit and Investment Risk

Investment risk disclosure is required for interest rate risk, credit risk (including custodial credit risk and concentrations of credit risk) and foreign currency risk.

6. Interest Rate Risk

County's Investment Pool - The Pool does not have a general policy to manage interest rate risk, however it is banned from purchasing Inverse Floaters, Range Notes, Interest only strips derived from a pool of mortgages, and any security that could result in zero interest accrual. It is limited on maturity levels, which in turn, allows the Pool to manage its exposure to fair value losses arising from increased rates (See **Table 7**).

Investments with Fiscal Agents - No general policies have been established to manage interest rate risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements. As of June 30, 2006, the following investments and maturities with fiscal agents were as shown on **Tables 8 and 11.**

SDCERA Investment Portfolio - SDCERA does not have a general policy to manage interest rate risk, but requires investment managers to diversify by issue, maturity, sector, coupon and geography. As of June 30, 2006, SDCERA had the following investments and maturities as shown on **Table 12.**

The *First 5 Commission of San Diego's* investment policy does not contain policies for exposure to interest rate risk. Information about the sensitivity of the fair values of the Commission's investments to market rate fluctuations is provided in **Table 13** that shows the distribution of the Commission's investments by maturity.

7. Credit Risk

County's Investment Pool - As of June 30, 2006, the Investment Pool's Security Ratings are shown on **Table 7.**

Investments with Fiscal Agents - No general policies have been established for credit risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements. The security ratings for these investments are shown on **Table 14.**

SDCERA Investment Portfolio - SDCERA's Investment guidelines address fixed income quality requirements by investment category. The overall weighted average investment grade held in domestic fixed income portfolios shall be no lower than AA by Standard & Poor's and Fitch's and Aa by Moody's. Domestic high yield fixed income portfolios must have a weighted average quality of B/B+ or higher (Moody or Standard & Poor's equivalent). Not rated issues are limited to 15% of the manager's portfolio. The overall weighted average grading for the Global fixed income portfolio shall be A-/A3 or higher. SDCERA has no policy for Emerging Market Fixed Income grading.

Tables 15 and 16 illustrate SDCERA's Fixed Income securities ratings as of June 30, 2006, shown as a percentage of the total portfolio.

Domestic Core Fixed Income Portfolio

SDCERA's Domestic Core Fixed Income portfolio includes government securities, collateralized mortgage obligations, corporate bonds, private placements, and other bonds. The overall weighted average rating for Domestic Fixed Income was AAA, excluding 5.1% of unrated securities.

Global Fixed Income Portfolio

SDCERA's Global Fixed Income portfolio includes corporate bonds and sovereign debt. The weighted average rating for Global Fixed Income portfolio was A, excluding 17.4% of unrated securities.

High Yield Fixed Income Portfolio

The weighted average quality of the High Yield Fixed Income Portfolio as of June 30, 2006 was B/BB, excluding 34.0% of unrated securities in the portfolio.

Emerging Market Debt

SDCERA's Emerging Market Debt portfolio invests in sovereign debt of emerging countries. As of June 30, 2006, the weighted average rating for Emerging Market Debt portfolio was rated B excluding 17.7% of unrated securities in the portfolio.

The *First 5 Commission of San Diego* investment policy does not contain policies for exposure to credit risk. **Table 17** presents the minimum rating required by the California Government Code Section 53601 (where applicable) and the actual rating as of year end for each investment type.

8. Concentration of Credit Risk

County's Investment Pool - The Pool Investment Policy limits the amount of exposure to any one single issuer. The Investment Policy is limited to 5% per issuer and cannot exceed this limit. An exclusion to this limit is dependent upon the weighted average days to maturity for commercial paper. If the weighted average days is 5 days or less the issuer limit can increase to 10% of total portfolio. The County of San Diego adheres to both State law and the County's Investment Policy for limits on investments.

Cash and Investments with Fiscal Agents - No general policies have been established to limit the amount of exposure to any one single issuer, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

SDCERA Investment Portfolio - Fixed income managers are expected to adhere to the following guidelines as a means of limiting credit risk. Domestic Fixed Income managers are limited within their portfolios to no more than 5% exposure in any single security, with the exception of United States Treasury and government agencies. Global and Tips Fixed Income managers are limited to 10% of a single issuer. High Yield and Convertible Fixed Income Managers limit is 8% exposure in any single security, with the exception of United States Treasury and government agencies. As of June 30, 2006, SDCERA has no single issuer that exceeds 5% of total fixed income investments.

The *First 5 Commission of San Diego* investment policy does not contain policies for exposure to concentration of credit risk. The California Government Code Section 53601 places limitations on the amount that can be invested in any one issuer. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% of more than total investments are presented in **Table 18.**

9. Custodial Credit Risk

County's Investment Pool - The County of San Diego does not invest in Category 3 type investments. The Investment policy does not permit investments in uninsured and unregistered securities not held by the County. However, the Policy does permit for securities lending transactions. The portfolio has not been exposed to these types of investments during the fiscal year.

Cash and Investments with Fiscal Agents - There are no general policies addressing custodial credit risk, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

SDCERA Investment Portfolio - SDCERA does not have a general policy addressing custodial credit risk, but it is the practice of the Fund that all investments are insured, registered, or held by the plan or its agent in the Plan's name. Deposits are to be insured, registered or collateralized with securities held at fiscal agents in the Plan's name. SDCERA also retains investment managers that specialize in the use of a particular asset class. Investment managers are subject to the guidelines and controls established in the SDCERA Investment Policy and contracts executed with the Board. SDCERA utilizes a third party as custodian over the plan assets.

In March 2005 the Board of Retirement completed a comprehensive asset/liability study that resulted in a new asset allocation strategy. This strategy specified an asset allocation target of 24% Domestic Equity, 25% International Equity, 31% Fixed Income, 10% Real Estate, 5% Commodities and 5% Alternative Equity.

First 5 Commission of San Diego - The California Government Code does not contain legal or policy requirements that would limit the exposure of custodial credit risk for deposits or investments other than the following provision for deposits: The California Government Code Section 53652 requires that a financial institution secure deposits made by state and local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure government deposits by pledging first trust deed mortgage notes having a value of 150% of the secure public deposits.

10. Foreign Currency Risk

County's Investment Pool - There are no general policies addressing foreign currency based securities, however the County does not invest in foreign currency based securities.

Cash and Investments with Fiscal Agents - There are no general policies addressing foreign currency based securities, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

SDCERA Investment Portfolio - SDCERA's investment policy allows international equity and fixed income managers to enter into foreign exchange contracts provided that the contracts have a maturity of one year or less and are limited to hedging currency exposure existing in the portfolio. SDCERA's exposure to foreign currency risk derives from its positions in foreign currency denominated international equity and fixed income investments as well as currency overlay exposure.

SDCERA's net exposure to foreign currency risk is shown on **Table 19**.

The *First 5 Commission of San Diego* does not have a policy related to foreign currency, however, the Commission does not invest in foreign currency based securities.

11. Securities Lending Transactions

County's Investment Pool - Although the Pool's Policy permits securities lending transactions, the portfolio has not been exposed to these types of investments during the fiscal year.

Cash and Investments with Fiscal Agents - There are no general policies addressing securities lending transactions, however, moneys held by trustees on behalf of the County may generally only be invested in permitted investments specified in trustee or indenture agreements.

SDCERA Investment Portfolio - SDCERA lends U.S. government obligations, domestic and international bonds, and equities to various brokers with a simultaneous agreement to return collateral for the same securities plus a fee in the future. The securities lending agent manages the securities lending program and receives securities and cash as collateral. Collateral cash is pledged at 102% and 105% of the fair value of domestic securities and non-domestic securities lent, respectively. There are no restrictions on the amount of securities that can be lent at one time. The term to maturity of the loaned securities is generally not matched with the term to maturity of the investment of the cash collateral.

SDCERA's securities lending transactions as of June 30, 2006, are summarized on **Table 20.** The Fund lent $591.768 million in securities and received collateral of $45.080 million and $557.938 million in securities and cash, respectively from borrowers.

SDCERA receives a premium on all securities it holds as collateral. As of June 30, 2006, the cash collateral that was received from the borrowers was then invested in the investment types as shown on **Table 21**.

Cash collateral is invested in the agent's short-term investment pool, which as of June 30, 2006 had a weighted average maturity of 54 days.

SDCERA does not have the ability to pledge or sell collateral securities without a borrower default. At the end of the fiscal year, SDCERA has no credit risk exposure to borrowers because the amounts the system owes them exceed the amounts they owe the system.

The *First 5 Commission of San Diego's* portfolio is governed by Government Code section 53601. Securities lending is authorized per the code, however, the commission did not have any exposure in Fiscal Year 2006.

12. SDCERA Derivative Financial Instruments

Swaps allow SDCERA to exchange a money market return for the rights to the return of a specific index, such as equity or commodity indices. As of June 30, 2006, SDCERA held S&P 500 swap contracts with a notional value of $1.4 billion and a fair value of $5.4 million, and a Goldman Sachs Commodity Index swap with a notional value of $346.9 million. SDCERA will only execute a swap agreement with a counterparty rated A or higher, as the use of swap agreements exposes the Plan to the risk the counterparty cannot fulfill their obligation. All swaps entered into by SDCERA are fully collateralized by cash at least equal to the notional value of the most recent reset. Allowing insufficient collateral is strictly prohibited by the Investment Policy.

Options and forwards are standard contracts utilized for exposure to the foreign currency markets due to the unlimited variation with respect to the size and term that is required by investors in this area. Options are contracts which give the buyer the right, but not the obligation, to buy or sell a specified quantity of a commodity, i.e. foreign currency, at a specified price within a specified period of time. Forwards are contracts on which a seller agrees to deliver a specified cash commodity to a buyer sometime in the future. Forward contracts are not traded on federally designated exchanges as the terms of the forward are not standardized, i.e. delivery time and amount are negotiated between the buyer and seller. SDCERA currently has $1 billion in exposure to foreign currency options and forwards through the Currency Overlay program, which is diversified across three currency overlay managers implementing four different strategies. In addition, SDCERA has $154.7 million in currency exposure through the policy overlay program.

Futures contracts are standardized according to the quality, quantity and delivery time and location for each commodity or instrument. Futures contracts are also traded on organized exchanges thereby minimizing counterparty risk. Futures contracts have daily cash settlement and the net gains and losses for the daily settlements are included in the Statement of Changes in Plan Net Assets.

As of June 30, 2006, SDCERA had total futures exposures of $475.35 million (See **Table 22**).

Derivative instruments are designed to provide equivalent exposure to the assets they emulate. SDCERA's use of swaps and futures is structured such that market exposure is fundamentally equivalent to a direct cash investment. SDCERA believes such vehicles offer significant advantages over a direct investment in the asset, including efficient use of capital, and lower transaction and custody costs.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 6

Deposits and Investments Reconciliation	Primary Government Governmental Activities	Business-Type Activities	Total Primary	First 5 Commission	Pension Trust Fund (SDCERA)	Investment Trust Fund	Agency Funds	Total
Pooled cash and investments	$ 1,087,269	78,286	1,165,555	19,110	3,023	2,415,542	429,093	4,032,323
Cash with fiscal agents	36,264		36,264				9,276	45,540
Restricted cash with fiscal agents	37,545		37,545					37,545
Subtotal: Cash with fiscal agent	73,809		73,809				9,276	83,085
Cash with fiscal agents - SDCERA					157,940			157,940
Total cash with fiscal agents	73,809		73,809		157,940		9,276	241,025
Investments with fiscal agents - current	39,674		39,674	165,930				
Restricted investments with fiscal agents - current	467,150		467,150					
Restricted investments with fiscal agents - noncurrent	338,173		338,173					
Investments with fiscal agent - noncurrent	29,346		29,346					
Total investments with fiscal agents	$ 874,343		874,343	165,930	7,883,930			
Reconciliation of pooled cash and investments:								
Investments in county pool	$ 3,993,869							
Add: Demand deposits	19,901							
Collections in transit	18,146							
Imprest cash	407							
Total pooled cash and investments	$ 4,032,323							
Reconciliation of pooled investments to Table 7:								
Investments in county pool	$ 3,993,869							
Add: Time deposits included in demand deposits above	1,691							
Investments in county pool - Table 7	$ 3,995,560							

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 7

Investments - County Pool										
Investment Type	MOODY'S Rating	S&P Rating	Rate Range %	Maturity Date Range	Par Value	Amortized Cost	Fair Value	Yield to Maturity	WAM	Percent of Total
U.S. Government Agencies:										
Federal Home Loan Bank Notes	Aaa	AAA	2.10-5.125	07/06-06/08	$ 564,585	$ 563,785	$ 559,438	3.15%	214	14%
Federal Home Loan Mortgage Corp. Notes	Aaa	AAA	2.25-5.50	12/06-12/08	473,075	472,573	468,533	4.59%	555	12%
Federal Nat'l Mortgage Assn. Notes	Aaa	AAA	2.05-5.00	07/06-06/08	326,316	326,316	323,382	3.00%	204	8%
Federal Farm Credit Bank Notes	Aaa	AAA	2.11-3.50	07/06-05/08	299,000	299,000	293,919	2.43%	208	7%
Short Term Notes:										
Commercial Paper	P-1	A-1+/ A-1	4.50-5.35	07/06-10/06	1,197,402	1,189,482	1,190,899	4.99%	37	30%
Medium-Term Notes	P-1	A-1+/ AAA	2.75-5.09	08/06-12/09	330,000	327,487	324,129	4.42%	246	8%
Asset-Backed Notes	Aaa	AAA	2.55-5.30	01/07-05/09	77,500	76,955	76,307	4.26%	530	2%
Repurchase Agreements	P-1	A-1	3.89-5.38	07/06	218,391	218,391	218,391	5.25%	3	5%
Negotiable Certificates of Deposit	P-2	A-1+/ A-1	4.62-5.40	07/06-11/06	485,000	484,970	484,821	5.07%	61	12%
Open-End Inst'l Money Market Funds	Aaa	AAA	4.91-5.34	07/06	54,050	54,050	54,050	5.26%	3	1%
Time Deposits*			3.89-5.08	08/06-05/07	1,691	1,691	1,691	4.54%	180	1%
Total Investments					$ 4,027,010	$ 4,014,700	$ 3,995,560	4.30%	177	100%

* Time deposits are classified as cash on hand and in banks.

Table 8

Investments - With Fiscal Agents									
Investment Type	MOODY'S Rating	S&P Rating	Maturity Under 1 Month	Maturity 1 to 6 months	Maturity 6 to 12 Months	Maturity Greater than 12 Months	Market Value	Coupon Rate	Maturity Date
IXIS Funding Corp. Investment Agreement	Unrated	Unrated	$ 250,000	$	$	$ 3,180	$ 253,180	NA	7/12/06 - 9/26/08
Fixed Income Tax Exempt Bonds	Various	Various	93,500	25,029		300,070	418,599	1.79% - 5.625%	7/1/06 - 2/1/42
Commercial Paper	Unrated	Unrated	6,967	13,701			20,668	NA	7/12/06 - 11/10/06
Federal Home Loan Bank	Aaa	AAA				9,816	9,816	5.270%	7/28/08
Federal Home Loan Mortgage Company	Aaa	AAA				9,882	9,882	5.460%	12/28/09
AIG Investment Agreement	Unrated	Unrated				14,155	14,155	NA	7/3/07
Rabobank Investment Agreement	Unrated	Unrated		49,080		5,583	54,663	NA	12/29/06 - 8/27/07
MBIA Inc Investment Agreement	Unrated	Unrated				15,185	15,185	NA	5/15/09 - 9/28/09
Federal National Mortgage Association Discount Notes	NA	A-1+		45,582			45,582	NA	11/10/06 - 12/1/06
Medium Term Notes	Aaa	AAA			2,963	9,648	12,611	5.150%	3/15/07 - 5/1/08
Negotiable CD's	Unrated	Unrated			20,000		20,000	NA	1/5/07
Common Stock	Aa2	AA-				2	2		
Total Investments			$ 350,467	$ 133,392	$ 22,963	$ 367,521	$ 874,343		

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 9

Investments - Pension Trust Fund (SDCERA)		Fair Value
Domestic equity securities	$	583,074
Cash, cash equivalents, and securities for Domestic equity swaps and alpha engine		1,478,932
International equity securities		1,845,546
Securities lending collateral		603,019
United States government obligations		471,528
Domestic corporate bonds		599,390
International bonds		850,359
Cash and securities for overlay futures		41,448
Cash and Securities for Commodity Swaps		382,815
Balanced fund		330,294
Alternative equity		240,983
Real estate		456,542
Total investments	$	7,883,930

Table 10

Investments - First 5 Commission		Fair Value
Federal Agency Securities	$	88,967
Medium Term Notes		6,980
Commercial Paper		9,969
Negotiable CD's		49,975
Money Market Fund		10,039
County Pool		19,110
Total investments	$	185,040

Note: Amounts invested in County Pool are reflected in the Pooled Cash and Investments for this component unit.

Table 11

Investments and Maturities - With Fiscal Agents

Investment Type		Market Value	Maturity Under 1 month	Maturity 1 to 6 Months	Maturity 6 to 12 Months	Maturity Greater than 12 Months
IXIS Funding Corp. Investment Agreement	$	253,180	250,000			3,180
Fixed Income Tax Exempt Bonds		418,599	93,500	25,029		300,070
Commercial Paper		20,668	6,967	13,701		
Federal Home Loan Bank		9,816				9,816
Federal Home Loan Mortgage Company		9,882				9,882
AIG Investment Agreement		14,155				14,155
Rabobank Investment Agreement		54,663		49,080		5,583
MBIA Inc Investment Agreement		15,185				15,185
Discount Notes		45,582		45,582		
Medium Term Notes		12,611			2,963	9,648
Negotiable CD's		20,000			20,000	
Common Stock		2				2
Total Investments	$	874,343	350,467	133,392	22,963	367,521

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 12

Investments and Maturities - SDCERA Investment Portfolio						
Investment Type		Fair Value	Maturity Less than 1 year	Maturity 1 to 5 years	Maturity 6 to 10 years	Maturity More than 10 years
Asset and mortgage backed securities	$	91,096			424	90,672
Collateralized mortgage obligations		119,714		241	159	119,314
Commercial paper		4,896	4,896			
Convertible Bonds		192,259	68,789	34,952	6,253	82,265
Corporate bonds		344,537	121,431	68,382	131,700	23,024
Emerging market debt securities		356,600	14,870	34,234	80,592	226,905
International bonds		248,291	4,209	83,200	90,848	70,036
International Governments		244,990		152,155	70,352	22,483
Managed Futures *		31,688	NA	NA	NA	NA
Private placements		30,448	902	6,941	15,641	6,964
Treasury inflation protected securities		232,808	384	64,491	97,362	70,570
US Treasuries		23,652	5,113	2,684	7,322	8,532
Total Investments**	$	1,920,979	220,594	447,280	500,653	720,765

* Investment maturities for Managed Futures are not available and are therefore not included in the subtotals by maturity.
** Excludes excess cash from Standish Mellon and PIMCO cash management

Table 13

Investments and Maturities - First 5 Commission					
Investment Type		Amount	12 months or less	13 to 24 months	25 to 60- months
Federal Agency Securities	$	88,967	37,570	24,833	26,564
Medium Term Notes		6,980	6,980		
Commercial Paper		9,969	9,969		
Negotiable CD's		49,975	49,975		
Money Market Fund		10,039	10,039		
County Pool		19,110	19,110		
Total	$	185,040	133,643	24,833	26,564

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 14

Securities Ratings - Investments With Fiscal Agents			
Fixed Income Tax Exempt Bonds:	S&P Rating	Market Value	Percent of Total
ALASKA ST HSG FIN CORP	AAA	$ 18,210	4%
ALTLANTA GA ARPT PASSENGER FAC	AAA	11,025	3%
BARTOW CNTY GA DEV AUTH POLLU	A	10,000	2%
BLACKROCK PROVIDENT INSTL FDS MUNI FUND INSTL	A-1	93,500	22%
CALIFORNIA ST DEPT WTR RES PWR	AAA	5,385	1%
CALIFORNIA ST DEPT WTR RES PWR	AAA	1,092	0%
CALIFORNIA STATEWIDE CMNTYS	AAA	25,029	6%
CALIFORNIA STATEWIDE CMNTYS	A+	6,349	2%
CALIFORNIA STATEWIDE CMNTYS	A+	4,861	1%
CHICAGO IL SCH FIN AUTH	NOT RATED	4,694	1%
DAPHNE AL SPL CARE FACS	AAA	5,752	1%
DELAWARE VALLEY PA REGL FIN	AAA	10,000	2%
GRAND TRAVERSE CNTY MI HOSP	NOT RATED	19,400	5%
HARRIS CNTY TX HLTH FACS HOSP	AAA	5,000	1%
HOUSTON TX UTIL SYS REV	AAA	5,000	1%
ILLINOIS ST	AA	3,333	1%
INDIANA HLTH FAC HOSP REV	AAA	8,325	2%
JEA FL ELEC SYS REV	AAA	15,000	4%
JEFFERSON CNTY AL SWR REV	AAA	20,000	5%
MEDFORD OR HOSP FACS AUTH REV	AAA	20,000	5%
METROPOLITAN TRANSN AUTH NY	AAA	20,000	5%
NEW YORK N Y	AAA	10,751	3%
NORTH CAROLINA CAP FACS FIN	NOT RATED	5,728	1%
OREGON ST DEPT ADMINISTRATIVE	AAA	6,114	1%
PUTNAM CNTY GA DEV AUTH POLLUT	A	19,025	5%
RALEIGH NC CTFS PARTN	AA+	1,019	0%
SEATTLE WA MUN LT + PWR REV	AAA	15,900	4%
SOUTH CAROLINA ST	AA+	9429	2%
UNIVERSITY AL UNIV REVS	AAA	7500	2%
WAKE CNTY NC INDL FACS + PLLTN	AAA	5000	1%
WAKE CNTY NC INDL FACS + PLLTN	AAA	10,000	2%
WAYNE CNTY ARPT AUTH REV	AAA	15,025	4%
WESTERN MN MUN PWR AGY TRANS	NOT RATED	1,153	0%
		$ 418,599	100%

Table 15

Fixed Income Securities Ratings - SDCERA Investment Portfolio					
Credit Risk	Domestic Core Fixed Income	Global Fixed Income	High Yield Fixed Income	Emerging Market Debt Fixed Income	Total*
Govt	$ 330,762	94,592			425,354
AAA	33,138	331,244			364,382
AA	6,445	6,489			12,934
A	20,606	104,854	79	30,061	155,600
BBB	29,874	83,878	7,426	64,366	185,544
BB	15,163	3,552	73,230	53,098	145,043
B	27,802	2,836	124,175	146,135	300,948
CCC	2,925		26,662		29,587
CC	846		3,676		4,522
C			4,952		4,952
NR	25,176	132,673	123,847	62,940	344,636
Total	$ 492,737	760,118	364,047	356,600	1,973,502

* Includes convertible securities for fixed income portfolio managers.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 16

Fixed Income Securities Ratings (Percent of Portfolio) SDCERA Investment Portfolio				
Credit Risk	Domestic Core Fixed Income	Global Fixed Income	High Yield Fixed Income	Emerging Market Debt Fixed Income
Govt	67.1%	12.4%	0.0%	0.0%
AAA	6.7%	43.6%	0.0%	0.0%
AA	1.3%	0.9%	0.0%	0.0%
A	4.2%	13.8%	0.0%	8.4%
BBB	6.1%	11.0%	2.0%	18.1%
BB	3.1%	0.5%	20.1%	14.9%
B	5.6%	0.4%	34.1%	41.0%
CCC	0.6%	0.0%	7.4%	0.0%
CC	0.2%	0.0%	1.0%	0.0%
C	0.0%	0.0%	1.4%	0.0%
NR	5.1%	17.4%	34.0%	17.6%
	100%	100%	100%	100%

Table 17

Securities Ratings - First 5 Commission			
Investment Type	Amount	Minimum Rating Required	Credit Quality Rating
Federal Agency Securities	$ 88,967	AAA	AAA
Medium Term Notes	6,980	A	A OR BETTER
Commercial Paper	9,969	A1	A1 OR BETTER
Negotiable CD's	49,975	N/A	A1 OR BETTER
Money Market Fund	10,039	AAA	AAAm
County Pool	19,110	VARIOUS	AAAf
Total	$ 185,040		

Note: Amounts invested in County Pool are reflected in the Pooled Cash and Investments for this component unit.

Table 18

Concentration of Credit Risk - First 5 Commission		
Issuer	Investment Type	Amount
Federal Home Loan Bank	Federal agency securities	$ 42,332
Federal Home Loan Mortgage Co.	Federal agency securities	46,635

Table 19

Foreign Currency Exposure - SDCERA Investment Portfolio	
Currency	Fair Value
EURO CURRENCY UNIT	$ 442,050
JAPANESE YEN	356,221
BRITISH POUND STERLING	264,894
U.S. DOLLAR	208,681
SOUTH KOREAN WON	96,655
HONG KONG DOLLAR	86,202
AUSTRALIAN DOLLAR	77,484
SWISS FRANC	69,730
CANADIAN DOLLAR	69,393
S AFRICAN COMM RAND	55,721
NEW TAIWAN DOLLAR	51,936
SINGAPORE DOLLAR	30,700
INDONESIAN RUPIAN	21,390
MEXICAN NEW PESO	18,312
NORWEGIAN KRONE	16,390
BRAZIL REAL	15,533
MALASIAN RINGGIT	8,099
DANISH KRONE	6,503
FORWARDS/ OTHER	6,290
SWEDISH KRONA	6,111
EGYPTIAN POUND	5,714
THAILAND BAHT	5,442
INDIAN RUPEE	5,083
TURKISH LYRA	5,004
CHILEAN PESO	4,109
HUNGARIAN FORINT	3,850
NEW ZEALAND DOLLAR	3,737
NEW TURKISH LIRA	2,873
Other (less than $2 million holdings)	2,789
Total	$ 1,946,896

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 20

Securities Lent - SDCERA Investment Portfolio			
Investment Type	SDCERA Securities Lent	Securities Received Value	Cash Received Value
Lent for Cash Collateral:			
U.S. Government and Agency securities	$ 10,000		10,173
International Governments securities	41,532		44,942
Treasury inflation protected securities	181,295		182,916
Domestic Corporate Fixed Income securities	51,827		52,840
Domestic Equities	50,350		51,223
International Equities	211,971		215,844
Lent for Securities Collateral:			
U.S. Government and Agency securities	5,115	5,163	
Treasury inflation protected securities	39,319	39,559	
International Equities	359	358	
Total	$ 591,768	45,080	557,938

Table 21

Securities Lending Transactions - SDCERA Investment Portfolio	
Investment Type	Fair Value
U.S. Corporate Floating Rate	$ 285,748
Asset Back Securities	64,674
Commercial Paper	102,169
Certificates of Deposit Floating Rate	49,342
Interest Bearing	2,093
Repurchase Agreements	97,855
Other (cash)	260
Total	$ 602,141

Table 22

Derivatives, Futures Exposures - SDCERA Investment Portfolio	
	Notional Amount Long/(Short)
Equity	
International Equity	$ 14,408
US Large & Small Cap	60,027
Total Equity	74,435
Fixed Income	
Global ex US Fixed Income	147,068
US Fixed Income	(21,155)
Total Fixed Income	125,913
Managed Futures Overlay	275,000
Total Futures Exposures	$ 475,348

B. Receivables

GASB Statement No.38 requires identification of receivable balances not expected to be collected within one year. **Table 23** below presents receivables at June 30, 2006 for the County's individual major funds, nonmajor governmental and enterprise funds, internal service funds and the discrete component unit including the applicable allowances for uncollectible accounts. The details of the receivables reported in the government-wide statement of net assets that are not expected to be collected within the next fiscal year are identified below:

- Due From Other Governmental Agencies

Of the $352,577 due from other governmental agencies for governmental activities, $41,121 is not expected to be received within the next fiscal year. This represents the amount the State of California owes to the County for Senate Bill (SB)90 mandated cost reimbursements for programs and services the State requires the County to provide. The State has deferred reimbursement to counties to future fiscal years, however, payment by the State began in Fiscal year 2007; hence this amount is expected to be received in the future.

- Notes Receivable

The $1,000 note receivable for governmental activities is due from the Metropolitan Area Advisory Committee to the Redevelopment Agency of the County of San Diego. The due date of the note is June 2063.

- Loans Receivable

$47,450 of loans receivable for governmental activities consist of loans for low-income housing programs such as down payments for closing costs, community development block grant loans, and various housing rehabilitation loan programs for low-income or special need residents. These loans are not expected to be repaid within the next fiscal year.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 23

Primary Government and Discretely Presented Component Unit Receivables	Accounts	Interest	Due From Other Gov't Agencies	Notes	Loans	Other	Total Receivables	Allowance For Doubtful Accounts	Receivables Net
Governmental activities:									
General Fund	$ 3,943	9,357	280,926		6,255		300,481	(4,337)	296,144
Tobacco Securitization Special Revenue Fund		1,898					1,898		1,898
Other governmental funds	4,643	3,853	67,179	1,000	41,195	5	117,875	(3)	117,872
Internal service funds	511	342	4,472				5,325		5,325
Total governmental activities	9,097	15,450	352,577	1,000	47,450	5	425,579	(4,340)	421,239
Business-type activities:									
Enterprise Fund	382	704	1,725				2,811		2,811
Component Unit:									
First 5 Commission		3,257	7,474				10,731		10,731

C. County Property on Lease to Others

The County has *noncancelable* operating leases for certain properties which are not material to the County's governmental operations, except for the aforementioned sublease of a share of the Metropolitan Transit System (MTS) Towers. In this regard, the share of the County's property under this lease is an estimated $12.74 million in land and structures and improvements with accumulated depreciation of $4.5 million at June 30, 2006.

Additionally, the Airport Enterprise Fund derives a substantial portion of its revenues from noncancelable operating leases with air carriers and concessionaires. The Airport Enterprise Fund's property under operating leases includes an estimated $2.6 million in land at June 30, 2006.

Lease revenues for both non-cancelable and cancelable leases for the year ended June 30, 2006 were approximately $22 million.

Future minimum *revenue* to be received under these noncancelable operating leases as of June 30, 2006 are noted below in **Table 24**. (One lease extends through 2091 for a two acre parcel leased to a non-profit public benefit corporation.)

Table 24

Lease Revenue County Property Leased To Others Fiscal Year	Minimum Lease Revenue
2007	$ 13,130
2008	12,490
2009	12,145
2010	11,400
2011	11,010
2091	167,069
Total	$ 227,244

D. Capital Assets

1. Primary Government

Capital asset activity for the year ended June 30, 2006 was as follows:

Governmental Activities:

On **Table 25** below**,** building and infrastructure projects are recorded as construction in progress until completion. Intangible projects such as software acquisition and implementation are recorded as contracts in progress until implementation is completed.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 25

Capital Assets - Governmental Activities	Beginning Balance at July 1	Increases	Decreases	Ending Balance at June 30
Capital assets, not being depreciated:				
Land	$ 266,960	9,753	(6,208)	270,505
Construction and contracts in progress	140,621	50,960	(17,064)	174,517
Total capital assets, not being depreciated	407,581	60,713	(23,272)	445,022
Capital assets, being depreciated:				
Buildings and improvements	962,630	17,085	(645)	979,070
Equipment	183,753	28,626	(7,547)	204,832
Software	47,696	7,784		55,480
Road network	2,119,848	47,818		2,167,666
Bridge network	39,953	1,097		41,050
Total capital assets, being depreciated	3,353,880	102,410	(8,192)	3,448,098
Less accumulated depreciation for:				
Buildings and improvements	(292,950)	(18,589)	292	(311,247)
Equipment	(95,387)	(16,996)	6,450	(105,933)
Software	-	(5,548)		(5,548)
Road network	(686,339)	(60,106)		(746,445)
Bridge network	(12,392)	(762)		(13,154)
Total accumulated depreciation	(1,087,068)	(102,001)	6,742	(1,182,327)
Total capital assets, being depreciated, net	2,266,812	409	(1,450)	2,265,771
Governmental activities capital assets, net	$ 2,674,393	61,122	(24,722)	2,710,793

Depreciation expense was charged to functions of the primary government as shown in **Table 26.**

Table 26

Depreciation Expense - Governmental Activities	
General government	$ 7,720
Public protection	16,363
Public ways and facilities	61,119
Health and sanitation	527
Public assistance	345
Education	48
Recreation and cultural	61
Internal Service Funds	15,818
Total Depreciation Expense - Governmental Activities	$ 102,001

Business Type Activities:

On **Table 27** below, building and infrastructure projects are recorded as construction in progress until completion.

Table 27

Capital Assets - Business Type Activities	Beginning Balance at July 1	Increases	Decreases	Ending Balance at June 30
Capital assets, not being depreciated:				
Land	$ 10,677	32		10,709
Construction and contracts in progress	16,812	15,804	(4,960)	27,656
Total capital assets, not being depreciated	27,489	15,836	(4,960)	38,365
Capital assets, being depreciated:				
Buildings and improvements	42,732	4,396		47,128
Equipment	1,206	46		1,252
Road network	139			139
Sewer network	64,782	591	(1,122)	64,251
Total capital assets, being depreciated	108,859	5,033	(1,122)	112,770
Less accumulated depreciation for:				
Buildings and improvements	(20,534)	(1,165)	269	(21,430)
Equipment	(895)	(54)		(949)
Road network		(3)		(3)
Sewer network	(27,338)	(1,241)		(28,579)
Total accumulated depreciation	(48,767)	(2,463)	269	(50,961)
Total capital assets, being depreciated, net	60,092	2,570	(853)	61,809
Enterprise fund capital assets, net	$ 87,581	18,406	(5,813)	100,174

(Amounts Expressed in Thousands Unless Otherwise Noted)

Depreciation expense was charged to *business type activities* as shown below:

Table 28

Depreciation Expense - Business Type Activities		
Airport Fund	$	1,070
Wastewater Management Fund		19
Sanitation Districts Fund		1,374
Total Depreciation expense - Business Type Activities	$	2,463

2. Capital Commitments

At June 30, 2006, major contracts entered into for software development, construction in progress, buildings, equipment and infrastructure are listed by fund within *governmental and business-type activities* as shown below:

Table 29

Capital Commitments	Project Title	Remaining
Governmental Activities: General Fund	Registrar of Voters-Integrated Voting System and Optional Items	$ 22,173
	Integrated Property Tax System (PTS)	27,622
	Regional Communications System Motorola Services and Equipment	4,089
	Automated Records MGMT & Field Reporting Cots Software Installation	1,555
	Public Health Information System Acquisition	1,397
	Sub Total	56,836
Other Governmental Funds	Construction of Valley Center Road, Phase II	33,024
	Construction of Wildcat Canyon Road Improvements	9,971
	Construction of Route 54/94 Improvements	9,669
	Construction of Forester Creek Drainage	2,831
	Construction of Edgemoor Skill Nursing Facility	44,350
	Construction of Spring Valley Gymnasium	1,696
	Construction of Medical Examiner and Veterinarian Building	1,074
	Sub Total	102,615
Business-type Activities: Enterprise Funds	Spring Valley Sewer Replacement	1,537
	Spring Valley Sewer Improvements	1,391
	Sub Total	2,928
	Total	$ 162,379

E. Payables

The County's payables at June 30, 2006 are shown below for the General Fund, other governmental funds, internal service funds, business type activities' funds, and the discrete component unit:

Table 30

Payables	Vendors	Due to Other Gov't Agencies	Other	Total Payables
Governmental Activities:				
General Fund	$ 79,221	16,932	2,930	99,083
Other governmental funds	15,730	2,481	1,940	20,151
Internal service funds	27,723	110	156	27,989
Total governmental activities	122,674	19,523	5,026	147,223
Business-type activities:				
Enterprise Funds	2,877	52	89	3,018
Component Unit:				
First 5 commission	5,852		1,842	7,694

F. Interfund Transactions

The composition of interfund balances as of June 30, 2006, is as follows:

1. Due To/Due From Other Funds

Due to/due from other funds shown in **Table 31** arise due to the exchange of goods or services between funds that were pending the transfer of cash as of June 30, 2006. These due to/from other funds have been eliminated in the government-wide financial statements, except for "internal balances" that are reflected between the governmental and business-type statements as of June 30, 2006.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 31

Due To/From Other Funds Receivable Fund	Payable Fund	Amount
General Fund	Tobacco Securitization Special Revenue Fund	$ 6,665
	Nonmajor Governmental Funds	48,585
	Nonmajor Enterprise Funds	53
	Internal Service Funds	53,854
Total General Fund		109,157
Nonmajor Governmental Funds	General Fund	5,501
	Nonmajor Governmental Funds	5,279
	Nonmajor Enterprise Funds	443
	Internal Service Funds	5,569
Total Nonmajor Governmental Funds		16,792
Nonmajor Enterprise Funds	General Fund	149
	Nonmajor Governmental Funds	357
	Nonmajor Enterprise Funds	493
	Internal Service Funds	1
Total Nonmajor Enterprise Funds		1,000
Internal Service Funds	General Fund	16,089
	Nonmajor Governmental Funds	3,034
	Nonmajor Enterprise Funds	199
	Internal Service Funds	487
Total Internal Service Funds		19,809
Total		$ 146,758

2. Advances

Advances to/from other funds at June 30, 2006 are noted on **Table 32** below. The purpose of these advances was primarily for the establishment of loans that are not due within one year. These loans are for the planning, undertaking, construction or operation of redevelopment projects within the County. Advances to/from other funds have been eliminated in the government-wide financial statements, except for "internal balances" that are reflected between the governmental and business-type statements as of June 30, 2006.

Table 32

Advances	Advances To Other Funds	Advances From Other Funds
General Fund	$ 906	
Nonmajor Governmental Funds	83	4,583
Nonmajor Enterprise Funds	3,363	217
Internal Service Funds	448	
Total	$ 4,800	4,800

3. Prior-Year Advance

The County Airport Enterprise Fund funded the initial expenditures of the San Diego County Redevelopment Agency's (Agency) two airport projects. The Agency is required to reimburse the Airport Enterprise Fund, which spent approximately $9.6 million on the projects. The Agency pays interest on advances, but is not responsible for payment until funds are available for this purpose. In December 2005, the Agency issued $16 million Revenue Refunding Bonds Series 2005A. A portion of the proceeds was used to pay $4.6 million of interest accrued on these advances and $5.7 million of principal to the County's Airport Enterprise Fund. As of June 30, 2006 all of the interest due on the advances has been paid.

4. Transfers In/Transfers Out

The purposes of these transfers were primarily for reimbursement of project costs, lease payments, initiation fees and replacement costs. Transfers in/transfers out at June 30, 2006 were as follows:

Table 33

Transfers In/Transfers Out From	To	Amount
General Fund	Nonmajor Governmental Funds	$ 147,379
	Internal Service Funds	4,017
	Nonmajor Enterprise Funds	107
Total General Fund		151,503
Tobacco Securitization Special Revenue Fund	General Fund	24,558
Nonmajor Governmental Funds	General Fund	461,072
	Nonmajor Governmental Funds	103,474
	Internal Service Funds	4,786

(Amounts Expressed in Thousands Unless Otherwise Noted)

Transfers In/Transfers Out		
From	To	Amount
(Table 33 Continued)		
	Tobacco Securitization	$ 123,515
Total Nonmajor Governmental Funds		692,847
Nonmajor Enterprise Funds	Nonmajor Governmental Funds	594
	Internal Service Funds	603
Total Nonmajor Enterprise Funds		1,197
Internal Service Funds	General Fund	573
	Nonmajor Governmental Funds	6,808
Total Internal Service Funds		7,381
Total		$ 877,486

G. Short-Term Obligations

The County's short-term borrowing program consists of its annual Tax and Revenue Anticipation Notes (Notes), which fund the County's annual operating cash flow needs, and the issuance of Teeter Commercial Paper, which fund payments to public agencies their full share of property taxes levied. The County bears the risk of loss on delinquent property taxes that go unpaid; however, it also benefits from the penalties associated with these delinquent property taxes when they are paid.

On July 1, 2005, the County of San Diego issued $250 million of Notes with an interest and principal maturity date of July 14, 2006. The Notes carry an interest rate of 4.00% and a yield of 2.58%. The amount outstanding at June 30, 2006 is $250 million.

In 1995 the County of San Diego Board of Supervisors approved the Master Teeter Resolution providing the terms and conditions of its Teeter plan obligations. Pursuant to this resolution, the County is able to issue additional Series B Teeter Commercial Paper each fiscal year. In June 2006 the County paid off the remaining Teeter Commercial Paper outstanding and did not issue Teeter Commercial Paper to finance the buyout of the Fiscal Year ended June 30, 2006 delinquent Secured Property Taxes.

Short-term obligation activity for the year ended June 30, 2006 was as follows:

Table 34

Short-Term Obligations	Beginning Balance at July 1, 2005	Issued	Redeemed	Ending Balance at June 30, 2006
Tax and Revenue Anticipation Notes	$ 369,280	250,000	369,280	250,000
Teeter B-1 Tax - Exempt Principal	62,990		62,990	
Teeter B-2 Taxable Principal	12,000		12,000	
Total Teeter	$ 444,270	250,000	444,270	250,000

H. Lease Obligations

1. Lease Commitments- Real Property

The County has commitments under long-term property operating lease agreements for facilities used for operations through fiscal year 2013 (**Table 35** below). These leases do not meet the criteria for capitalization under FASB Statement 13. The County is the lessee under the terms of several non-cancelable operating leases for real property used to house certain County facilities. Total rental expense for all real property operating leases, including short-term cancelable leases for the year ended June 30, 2006, was approximately $26.5 million.

The combined rental cost for which the County is obligated under these leases is as follows:

Table 35

Lease Commitments - Real Property Fiscal Year	Minimum Lease Payments
2007	$ 8,642
2008	5,197
2009	4,644
2010	3,627
2011	3,090
2012-2013	1,564
Total	$ 26,764

2. Lease Commitments- Personal Property

The County has also entered into long-term operating leases for personal property, a large portion of which represents data processing and duplicating equipment. Many of these leases are subject to annual adjustment based upon negotiations. Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases. Total rental expense for these operating leases for the year ended June 30, 2006, was $2.7million.

(Amounts Expressed in Thousands Unless Otherwise Noted)

3. Capital Leases

a. Minimum Lease Payments

Certain buildings and equipment are being leased under capital leases as defined in FASB Statement 13. The present value of the minimum lease obligation has been capitalized in the statement of net assets and is reflected as a liability in that statement. The County assumes responsibility for all maintenance, repair, and structural modifications under the terms of the lease agreements. Future minimum lease payments (**Table 36** below) under capital leases at June 30, 2006 were as follows:

Table 36

Capital Leases - Future Minimum Lease Payments	Amount
2007	$ 3,785
2008	3,454
2009	3,068
2010	3,053
2011	3,130
2012-2016	15,247
2017-2020	12,242
Total minimum lease payments	43,979
Less: amount representing interest	(12,085)
Net lease payments	$ 31,894

b. Book Value

The book value of capital lease property at June 30, 2006 consisted of the following:

Table 37

Capital Leases - Book Value Capital Lease Property	Original Cost	Accumulated Depreciation	Net Book Value June 30, 2006
Land	$ 2,221		2,221
Buildings and Improvements	52,314	17,243	35,071
Total	$ 54,535	17,243	37,292

I. General Long-Term Obligations

Outstanding general long-term obligations at June 30, 2006 consist of certificates of participation, taxable pension obligation bonds, capital appreciation bonds (CABs), current Interest bonds, revenue bonds, capital loans, capital lease obligations, capital financing leases, and other long-term obligations.

As further explained below, CABs are bonds that are issued at a deep discount and are presented at their maturity value, less the unaccreted appreciation. This unaccreted appreciation represents the difference between the maturity value of the CABs and their face (par) value. The unaccreted appreciation is accreted as interest over the life of the CABs.

During prior fiscal years and in the fiscal year ended June 30, 2006, the County refunded some of its existing debt. The difference between the amount borrowed and the amount sent to the paying agent is the unamortized deferred amounts on refundings. The amortized amount is an adjustment to interest expense in the statement of activities over the remaining life of the refunded debt.

Premiums applicable to debt issued in excess of par value are amortized as a reduction of interest expense over the life of the debt issuance. Similarly, discounts applicable to debt issued at amounts less than the face (par) value are amortized as an increase to interest expense over the life of the debt issued.

All obligations listed, carry a fixed interest rate with the exception of $505.125 million of the 2002 taxable pension obligation bonds series B1 and B2-4 and $147.825 million of the 2004 taxable pension obligation bonds series B1-2 which are variable rate and are subject to market fluctuations. The interest rate range listed in **Table 38** below displays the range of interest rates on the serial, term bonds or in the case of capital leases, the range of rates for various leases. The variable index used to calculate the interest due on the 2002 taxable pension obligation bonds Series B1 and for the 2004 taxable pension obligation bonds Series B1-2 is the one-month London Interbank Offered Rate (LIBOR). The June 30, 2006 one-month LIBOR was 5.33%. The variable rate used for the 2002 taxable pension obligation bonds Series B2-4 is 5.23%, which represents the average auction rate bond coupon for June 2006. The maximum interest rate on these bonds shall not exceed 17% per annum.

1. Outstanding long-term obligations

Governmental Activities:

Long-term obligations for *governmental activities* at June 30, 2006 are presented in **Table 38**.

The certificates of participation (COPs) of the SANCAL, a non-profit corporation, are secured by annual base rental lease payments payable primarily by the County General Fund for use of the facilities constructed or equipment purchased with the proceeds. There are also encumbrances on the facilities constructed or purchased with the proceeds of the SANCAL. The capital leases between the County and SANCAL have been eliminated for financial reporting purposes and the related assets and long-term obligations (e.g. certificates of participation of SANCAL) are reported as San Diego County's assets and debt, respectively.

The Pension Obligation 2004 Series C Capital Appreciation Bonds (CABs) and the San Diego County Tobacco Asset Securitization Corporation CABs represent bonds that were issued at stated interest rates significantly below their effective interest rates, resulting in a substantial discount. The implicit interest, i.e. discount (unaccreted appreciation), is not paid until the bonds begin to mature. Therefore, the net value of the bonds "accretes" each year. In **Table 38** below, the CABs are shown at their maturity value (original amount issued plus total amount to be accreted (appreciated) over the life of the debt), less the unaccreted appreciation (total amount to be accreted over the life of the debt, less the amount accreted to date).

At June 30, 2006, the 2004 Taxable Pension Obligation Series C CABs outstanding balance was $72.05 million which includes accreted interest of $7.122 million. The San Diego County Tobacco Asset Securitization Corporation (Corporation) Series 2006 B CABs outstanding balance was $19.874 million which includes accreted interest of $104 thousand. The Corporation Series 2006 C CABs outstanding balance was $8.733 million which includes accreted interest of $47 thousand. The Corporation Series D CABs outstanding balance was $20.687 million which includes accreted interest of $122 thousand.

In compliance with the Tax Reform Act of 1986 and subsequent U.S. Treasury Regulations, the County performed arbitrage rebate calculations via a third party to determine probable amounts due to the Federal government. At June 30, 2006, the probable arbitrage rebate was zero.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 38

Long-Term Obligations - Governmental Activities	Interest Rate	Final Maturity Date	Original Amount	Amount Outstanding
Certificates of Participation:				
1993 Master Refunding	2.50 - 5.625%	2012	$ 203,400	$ 57,600
1997 Central Jail	4.00 - 5.42%	2025	80,675	65,415
1998 Downtown Courthouse	4.00 - 4.94%	2023	73,115	51,905
1999 East Mesa	3.60 - 4.75%	2009	15,010	6,780
2000 ITS	4.50 - 5.125%	2010	51,620	23,715
2002 Motorola	2.00 - 5.00%	2011	26,060	15,320
2005 Edgemoor	3.00 - 5.00%	2030	112,395	107,745
2005 N&E Refunding	3.25 - 5.00%	2020	28,210	28,210
Total Certificates of Participation			590,485	356,690
Taxable Pension Obligation Bonds:				
1994 Series A	4.70 - 6.60%	2007	430,430	39,830
2002 Series A	3.88 - 4.95%	2016	132,215	132,215
2002 Series B1	variable	2033	100,000	100,000
2002 Series B2-4	variable	2031	405,125	405,125
2002 Series C	6.125%	2033	100,000	100,000
2004 Series A	3.28 - 5.86%	2023	241,360	241,360
2004 Series B1-2	variable	2025	147,825	147,825
2004 Series C CABs	4.66 - 5.76%	2016	64,928	100,170
2004 Unaccreted Appreciation CABs				(28,120)
Total Taxable Pension Obligation Bonds			1,621,883	1,238,405
San Diego County Tobacco Securitization Corporation:				
Series 2006 Senior Current Interest Bonds	4.75 - 5.125%	2025 - 2029	534,610	534,610
Series 2006B CABs	6.25%	2031	19,770	88,052
2006B Unaccreted Appreciation CABs				(68,178)
Series 2006C CABs	6.40%	2032	8,686	43,893
2006C Unaccreted Appreciation CABs				(35,160)
Series 2006D CABs	7.10%	2035	20,565	141,176
2006D Unaccreted Appreciation CABs				(120,489)
Total San Diego County Tobacco Asset Securitization Corporation			583,631	583,904
Redevelopment Agency				
Revenue Refunding Bonds Series 2005A	3.65 - 5.75%	2033	16,000	16,000
Capital Loans:				
Alpine Highlands Zone #1010	7.75%	2007	436	58
Singing Trails Zone #1013	8.75%	2008	66	26
Pauma Heights PRD #21	7.75%	2009	160	96
Firebird Manor	1.00%	2028	4,486	3,219
California Energy Comm Loan 1 (Facilities ISF)	4.00%	2014	1,977	1,698
California Energy Comm Loan 2 (Facilities ISF)	3.95%	2015	3,001	3,001
Total Capital Loans			10,126	8,098
Total Bonds and Notes payable, before issuance discounts and premiums and deferred amounts on refundings:			2,822,125	2,203,097
Unamortized Issuance Premiums			8,033	7,257
Unamortized Issuance Discounts			(31,745)	(22,602)
Unamortized Deferred Amounts on Refundings			(68,532)	(48,583)
Total Bonds and Notes Payable, net			2,729,881	2,139,169
Capitalized Leases:				
San Diego Regional Building Authority	3.65 - 5.75%	2019	36,960	30,845
S&L Development	8.00%	2008	$ 1,056	$ 283

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 38

Long-Term Obligations - Governmental Activities	Interest Rate	Final Maturity Date	Original Amount	Amount Outstanding
(Table 38 Continued)				
Koch Lighting	4.245 - 5.91%	2008	$ 7,649	$ 766
Total Capitalized Leases			45,665	31,894
Claims and judgements - ISF				122,332
Non-Internal Service Funds Compensated Absences				76,141
Internal Service Funds Compensated Absences				2,289
Landfill closure and postclosure				24,447
Total Other Liabilities				225,209
Total Governmental Activities			$ 2,775,546	$ 2,396,272

Business-Type Activities:

Long-term obligations for business-type activities at June 30, 2006 were as follows:

Table 39

Long-Term Obligations - Business-Type Activities	Interest Rate	Final Maturity Date	Original Amount	Amount Out-standing
Enterprise funds				
Capital loans:				
Department of Transportation				
Beginning March 2001	5.63%	2019	$ 3,584	2,652
US Department of Agriculture				
Beginning December 2003	4.63%	2040	100	93
Compensated absences				389
Total business-type activities			$ 3,684	3,134

2. Debt Service Requirements to Maturity

Governmental Activities:

Debt service requirements to maturity for *governmental activities'* long-term bond and note obligations outstanding at June 30, 2006 are shown below. (Note: **Table 40** does not reflect the County's exposure to the interest rate swap on the 2002 Taxable Pension Obligation Bonds. See Note IV-J Interest Rate Swap for further information.)

Table 40

Debt Service Requirements To Maturity - Governmental Activities Fiscal year Ending June 30	Principal	Unaccreted Appreciation	Interest	Total
2007	$ 77,423	5,416	105,888	188,727
2008	67,326	7,499	102,209	177,034
2009	66,504	7,951	99,149	173,604
2010	67,467	8,157	98,868	174,492
2011	62,372	8,052	97,129	167,553
2012-2016	294,092	35,975	463,340	793,407
2017-2021	445,371	36,471	348,907	830,749
2022-2026	571,334	50,656	210,434	832,424
2027-2031	410,763	66,341	81,808	558,912
2032-2035	133,050	25,429	6,463	164,942
Subtotal	2,195,702	251,947	1,614,195	4,061,844
Add: Accreted appreciation through June 30	7,395			7,395
Subtotal	2,203,097	251,947	1,614,195	4,069,239
Add: Unamortized issuance Premium	7,257			
Less: Unamortized issuance discount	(22,602)			
Unamortized deferred amount on refunding	(48,583)			
Total	$ 2,139,169			

Business-Type Activities:

Debt service requirements to maturity for *business-type activities'* capital loans obligations outstanding at June 30, 2006 were the following:

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 41

Debt Service Requirements to Maturity - Business Type Activities			
Fiscal Year Ending June 30	Principal	Interest	Total
2007	$ 193	153	346
2008	206	143	349
2009	218	131	349
2010	231	119	350
2011	243	106	349
2012-2016	1,404	310	1,714
2017-2021	182	27	209
2022-2026	13	14	27
2027-2031	17	11	28
2032-2036	21	7	28
2037-2040	17	2	19
Total	$ 2,745	1,023	3,768

3. Prior Year Defeasance of Long-Term Debt

In prior years, the County defeased certain certificates of participation (COPs) and taxable pension obligation bonds by placing the proceeds of the original issue plus additional County contributions in an irrevocable trust to provide for all future debt service payments on the old obligations. Accordingly, the trust account assets and the liability for the defeased obligations are not included in the County's financial statements. At June 30, 2006, $75 million of bonds and COPs were legally defeased and remain outstanding.

4. Advance Refunding of Long-Term Debt Including New Long-Term Debt

- *San Diego County Asset Leasing Corporation 2005 North and East Justice Facilities Refunding*

In September 2005, the San Diego County Capital Asset Leasing Corporation (SANCAL) issued $28.21 million of fixed rate serial certificates of participation titled "2005 North and East County Justice Facilities Refunding" (the "Certificates"). A portion of the Certificates mature every November beginning in November 2006 with a final maturity of November 2019. Each maturity date carries a different fixed interest rate beginning in November 2006 at 3.25% escalating each year to the November 2019 maturity date at 5.00%. The face value of the new certificates attributed to the refunding was $28.21 million.

These Certificates were issued with a premium of $1.308 million. Certificate proceeds of $29.518 million along with $5.842 million of funds held by the 1996 North County Regional Center Expansion and East County Courthouse Detention Facility Conversion trustee (trustee) were distributed as follows: 1)$32.076 million (consisting of $28.96 million of new certificate proceeds plus $3.116 million of funds held by the trustee) was transferred to an escrow agent to advance refund the $30.595 million in outstanding 1996 North County Regional Center Expansion and East County Courthouse Detention Facility Conversion certificates of participation and to pay future interest payments; 2)$2.726 million of funds held by trustee were used to fund a certificate reserve fund; 3) $538 thousand was deposited to a cost of issuance account, of which $508 thousand of costs of issuance expenditures were incurred in fiscal year 2006, the remaining $30 thousand dollars will be used to pay future debt service principal payments; and 4) $20 thousand was set aside to be used for various ongoing debt related costs.

The $32.076 million transfer referred to above was placed in an irrevocable trust with an escrow agent to provide for the payment of the remaining principal and interest due on the outstanding 1996 North County Regional Center Expansion and East County Courthouse Detention Facility Conversion on November 15, 2006 along with a two percent premium. As a result, the 1996 North County Regional Center Expansion and East County Courthouse Detention Facility Conversion are considered legally defeased and the liability for those bonds has been removed from the government-wide statement of net assets governmental activities current and non-current. This advance refunding will result in reducing the County's principal and interest payments by $1.993 million over the next 14 years to obtain an economic gain of $1.066

million (i.e. difference between the present values of the debt service payments on the refunded debt and the refunding debt).

- *San Diego County Tobacco Asset Securitization Corporation Series Tobacco Settlement Asset Backed Bonds*

In May 2006, the Tobacco Securitization Joint Powers Authority of Southern California issued $583.631 million Series 2006 Tobacco Settlement Asset-Backed bonds as follows: 1) $534.610 million Senior 2006A Current Interest (Turbo Term) Bonds that carry a fixed coupon minimum rate of 4.75% and a maximum coupon rate of 5.125% along with a projected yield rates ranging from 4.85% to 5.40% and final maturity dates ranging from June 2025 through June 2029; 2) Series 2006B First Subordinate Capital Appreciation Bonds (CABs) issued at the initial principal amount of $19.770 million with a projected yield rate of 6.25% that mature on June 1, 2031 with a maturity value of $88.052 million due to expected turbo payments to be made beginning June 1, 2029; 3) Series 2006C Second subordinate CABs issued at the initial principal amount of $8.686 million with a projected yield rate of $6.40% that mature on June 1, 2032 with a maturity value of $43.893 million due to expected turbo payments to be made beginning June 1, 2031; 4) Series 2006D Third Subordinate CABs issued at the initial principal amount of $20.565 million with a projected yield rate of 7.10% that mature on June 1, 2035 with a maturity value of $141.176 million due to expected turbo payments to be made beginning June 1, 2032. The face value of the new certificates attributed to refunding debt was $428.8 million.

The bonds noted above, were issued with a discount of $20.455 million and the proceeds of $563.176 million ($583.631 million total proceeds less a bond discount of $20.455 million) along with approximately $67.084 million from funds held by the 2001 Indenture trustee accounts (trustee) were distributed as follows: 1) $123.515 million was used to fund a grant to the County's Tobacco Securitization Special Revenue Fund; 2) $455.391 million (consisting of $434.251 million of new bond proceeds plus $21.14 million of funds held by the trustee) was transferred to the escrow agent for the bond refunding to advance refund the outstanding $428.8 million 2001A and 2001B Tobacco Settlement Asset-Backed Bonds and future interest payments; 3) $12.261 million to fund the 2006 Capital Interest Sub Account (including $12.149 of funds held by the trustee); 4) $33.595 million of funds held by the trustee were used to fund the liquidity reserve and reserve termination payment accounts; 5) $200 thousand of funds held by the trustee was deposited into the Operations account and 6) $5.298 million to fund a cost of issuance account to pay cost of issuance incurred in connection with the Series 2006 Tobacco bonds totaling $5.249 million.

The proceeds of $455.391 million referred to above were deposited into an irrevocable escrow trust fund established under the Refunding Escrow Agreement dated May 1, 2006 between the Authority and the 2001 Indenture Trustee. The funds deposited in the irrevocable escrow fund are expected to generate sufficient cash flow to pay the principal and interest on the bonds as they become due. As a result, the Series 2001 bonds are considered to be legally defeased and the liability for those bonds has been removed from the statement of net assets governmental activities current and non-current. The advance refunding will result in increasing the County's principal and interest payments by $53.6 million over the next 22 years for an economic loss (i.e. difference between the present value of the old and new debt service payments) of $10.9 million.

- *Redevelopment Agency of the County of San Diego Gillespie Field Project Revenue Refunding Bonds*

In December 2005, the Redevelopment Agency of the County of San Diego issued $16 million of Gillespie Field Project Revenue Refunding Bonds (Gillespie), Series 2005A ("Bonds") consisting of $9.225 million Series A-1 bonds and $6.775 million Series 2005 AMT bonds.

The $9.225 million Series 2005 A-1 bonds consist of: 1) $7.035 million Serial Series 2005 A-1 bonds that carry fixed interest rates ranging from 3.65% to 5.3% along with a projected yield ranging from 3.65% to 5.3%, with a portion of the principal due each fiscal year beginning in fiscal year 2007, with a final maturity date of December 1, 2025; and, 2) $2.19 million Series 2005 A-1 Term Bonds that carry a fixed interest rate of 5.4% along with a projected yield of 5.45%, with a portion of the principal due each fiscal year beginning in fiscal year 2007, with a final maturity date of December 1, 2025.

The $6.775 million Series 2005 AMT Term Bonds carry a fixed interest rate of 5.75% along with a projected yield of 5.75%. Interest is paid on the $6.775 million Series 2005 AMT Term Bonds each fiscal year beginning in Fiscal Year 2007. However, no principal payments are made December 1, 2025. A portion of the principal is due each fiscal year beginning in Fiscal Year 2026, with a final maturity date of December 1, 2032. Payments for the entire $16 million Gillespie bond issuance are to be paid from tax increment revenues received and loans from the County's Airport Enterprise Fund, as needed. The face value of these new bonds attributed to the refunding was $4.22 million.

The aforementioned Gillespie bonds were issued at a discount of $46 thousand. Proceeds of $15.954 million along with $468 thousand of funds held by the 1995 Gillespie Project trustee (trustee) were distributed as follows: 1) $4.247 million was deposited into trust with an escrow agent to advance refund the outstanding $4.11 million in 1995 Gillespie Project Revenue Bonds and future interest payments; 2) $1.155 million (including $468 thousand of funds held by the trustee) was deposited into a reserve fund; 3) $387 thousand was used to contribute to the payment of certain cost of issuance that subsequently within fiscal year 2006 totaled $415 thousand in connection with the issuance of the bonds; 4) $37 thousand of the remaining proceeds was deposited in the Redevelopment Agency's Capital Project fund; and, 5) $10.596 was transferred to the County's Airport Enterprise Fund in repayment of a portion of the outstanding principal and the entire accrued interest on the loan from the County's Airport Enterprise Fund.

With regard to the $10.596 million transfer, $5.917 million was deposited in the Alternative Minimum Tax (AMT) project funds and $4.483 million was deposited in the Non Alternative Minimum Tax project funds. These monies and the remaining $196 thousand will be used to finance redevelopment activities in the Gillespie Field project area.

The $4.247 million deposit referred to above was placed in an irrevocable trust with an escrow agent and these monies were used to pay the remaining debt service payments on the 1995 Gillespie Project Revenue Bonds on February 1, 2006. As a result, the 1995 Revenue Bonds are considered to be legally defeased and the liability for those bonds has been removed from the government-wide statement of net assets governmental activities current and non current.

The advance refunding resulted in reducing the debt service payments by $593 thousand over the next 15 years to obtain an economic gain of $302 thousand.

5. Changes in Long-Term Obligations

Long-term obligation activity (Governmental Activities) for the year ended June 30, 2006 is presented in **Table 42.**

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 42

Changes in Long Term Obligations- Governmental Activities	Beginning Balance at July 1	Additions	Reductions	Accreted Interest	Ending Balance at June 30,	Amounts Due Within One Year
Certificates of Participation						
1993 Master Refunding	$ 72,545		(14,945)		57,600	15,800
1996 N&E Courthouse	30,595		(30,595)			
1997 Central Jail	67,635		(2,220)		65,415	2,320
1998 Downtown Courthouse	54,875		(2,970)		51,905	3,085
1999 East Mesa	8,295		(1,515)		6,780	1,580
2000 ITS	28,970		(5,255)		23,715	5,505
2002 Motorola	18,085		(2,765)		15,320	2,850
2005 Edgemoor	112,395		(4,650)		107,745	2,035
2005 N&E Refunding		28,210			28,210	1,550
Total Certificates of Participation	393,395	28,210	(64,915)		356,690	34,725
Taxable Pension Obligation Bonds						
1994 Series A	60,790		(20,960)		39,830	25,755
2002 Series A	132,215				132,215	
2002 Series B1	100,000				100,000	
2002 Series B2-4	405,125				405,125	
2002 Series C	100,000				100,000	
2004 Series A	241,360				241,360	9,605
2004 Series B1-2	147,825				147,825	
2004 Series C CABs	64,928	35,242			100,170	
2004 Series C Unaccreted Appreciation CABs		(35,242)		7,122	(28,120)	
Total Taxable Pension Obligation Bonds	1,252,243		(20,960)	7,122	1,238,405	35,360
San Diego County Tobacco Asset Securitization Corporation						
Series 2001 Asset Backed Bonds	430,350		(430,350)			
Series 2006A Senior Current Interest Bonds		534,610			534,610	6,375
Series 2006B CABs		88,052			88,052	
Series 2006B Unaccreted Appreciation CABs		(68,282)		104	(68,178)	
Series 2006C CABs		43,893			43,893	
Series 2006C Unaccreted Appreciation CABs		(35,207)		47	(35,160)	
Series 2006D CABs		141,176			141,176	
Series 2006D Unaccreted Appreciation CABs		(120,611)		122	(120,489)	
Total San Diego County Tobacco Securitization Corporation	430,350	583,631	(430,350)	273	583,904	6,375
Redevelopment Agency						
Redevelopment Agency 1995	4,260		(4,260)			
Revenue Refunding Bonds Series 2005A		16,000			16,000	360
Total Redevelopment Agency	4,260	16,000	(4,260)		16,000	360
Capital Loans						
Alpine Highlands Zone #1010	150		(92)		58	58
Singing Trails Zone #1013	39		(13)		26	13
Pauma Heights PRD #21	128		(32)		96	32
Firebird Manor	3,351		(132)		3,219	132
California Energy Comm Loan 1 (Facilities ISF)	1,863		(165)		1,698	171
California Energy Comm Loan 2 (Facilities ISF)	1,785	1,216			3,001	197
Total Capital Loans	7,316	1,216	(434)		8,098	603
Total Bonds and Notes payable, before issuance discount and Premium and deferred amount on refunding	2,087,564	629,057	(520,919)	7,395	2,203,097	77,423
Unamortized Issuance Premiums	6,031	1,308	(82)		7,257	408
Unamortized Issuance Discounts	(9,054)	(20,501)	6,953		(22,602)	(635)
Unamortized Deferred Amounts on Refundings	(12,103)	(44,101)	7,621		(48,583)	(11,519)
Total Bonds and Notes Payable, net	2,072,438	565,763	(506,427)	7,395	2,139,169	65,677
Capitalized Leases						
San Diego Regional Building Authority	$ 32,380		(1,535)		30,845	1,595

(Amounts Expressed in Thousands Unless Otherwise Noted)

Table 42

Changes in Long Term Obligations- Governmental Activities	Beginning Balance at July 1	Additions	Reductions	Accreted Interest	Ending Balance at June 30,	Amounts Due Within One Year
(Table 42 Continued)						
S&L Development	$ 409		(126)		283	158
Koch Lighting	1,825		(1,059)		766	540
S&L Development ISF	11		(11)			
Total Capitalized Leases	34,625		(2,731)		31,894	2,293
Claims and Judgements - ISFs	103,569	52,908	(34,145)		122,332	35,180
Non Internal Service Funds Compensated Absences	74,429	57,787	(56,075)		76,141	1,793
Internal Service Funds Compensated Absences	2,240	1,428	(1,379)		2,289	47
Landfill closure and postclosure	47,891		(23,444)		24,447	2,627
Total Governmental Activities	$ 2,335,192	677,886	(624,201)	7,395	2,396,272	107,617

The following funds presented in **Table 43** below have typically been used to liquidate other long-term liabilities in prior years:

Table 43

Liquidated Liabilities

Liability	Fund(s) Used to Liquidate in Prior Years
Claims and Judgments	Internal Service Fund - Risk Financing
Compensated Absences	General Fund; Special Revenue Funds - County Library, Road, Cable TV and Air Pollution; Internal Service Funds - Facilities Management, Fleet Services and Purchasing
Landfill Closure and Postclosure	General Fund

Long-term obligations for Business Activities at June 30, 2006 was as follows:

Table 44

Changes in Long-Term Obligations - Business-Type Activities	Beginning Balance at July 1, 2005	Additions	Reductions	Ending Balance at June 30, 2006	Amounts Due within One Year
Enterprise Funds					
Capital loans	$ 2,926		(181)	2,745	193
Compensated absences	324	325	(260)	389	66
Total business-type activities	$ 3,250	325	(441)	3,134	259

J. Interest Rate Swap

To manage interest rate risk and lower the County's borrowing cost in its 2002 Taxable Pension Obligation Bonds, the County entered into an interest rate swap on September 17, 2002 with two counterparties. The swap converts the variable interest rates on several subseries of the 2002 Taxable Pension Obligation Bonds to a single long-term fixed rate that was lower than the "natural" fixed rate available at the time of the swap. The interest rate swap with Citibank N.A. (Citibank) and Morgan Stanley Capital Services (Morgan Stanley), (together the "counterparties") is governed by the International Swaps and Derivatives Association, Inc. Master Agreement (the Agreement) and a Confirmation. In fiscal year 2003, the County issued $737.340 million of Pension Obligation Bonds of which $505.125 million of the Series B Bonds are Auction Rate Securities. Within the Series B Auction Rate Securities there are the following subseries: $100 million of Series B-1, $135.025 million of Series B-2, $135.05 million Series of B-3 and $135.05 million of Series B-4 bonds. The County swapped Series B-2, B-3 and B-4 totaling $405.125 million of the Auction Rate Securities for a contractually agreed fixed interest rate of 5.30%. Of the $405.125 million our exposure with Citibank is $263.325 million and our exposure with Morgan Stanley is $141.8 million notional.

(Amounts Expressed in Thousands Unless Otherwise Noted)

Further details concerning this interest rate swap are discussed below:

1. Terms

County payments are due to bondholders semi-annually on August 15 and February 15, beginning February 15, 2003. The effective date of the swap was September 17, 2002 and the initial six-month calculation period began February 15, 2003. The Agreement and the Confirmation terminate on February 15, 2031 and the series B-2, B-3 and B-4 bonds mature on August 15, 2030. The County did not receive any upfront payments but pursuant to the terms of the Agreement, each August 15 and February 15 the County will receive an amount from each of the counterparties based on the notional amount of principal outstanding for the past six months at an interest rate of one month London Interbank Offered Rate (LIBOR) and each February 15 the County will pay the counterparties the scheduled 5.30% of the notional amount outstanding. The February 15 payment due from the counterparties will be netted against the 5.30% County payment. The notional amount of the swap will begin to decline in fiscal year 2017 in direct proportion to the repayment of the bonds.

The obligations of the County to make payments to the counterparties under this Agreement constitute general obligations of the County, payable from taxes, income, revenue cash receipts and other moneys of the County legally available in the General Fund. The payments due to the counterparties and the obligations of the County under this Agreement do not constitute any kind of indebtedness of the County as defined under and/or proscribed by any constitution, charter, law, rule, regulation, government code, constituent or governing instrument, resolution, guideline, ordinance, order, writ, judgment decree, or ruling.

As of June 30, 2006, the swap created a synthetic fixed rate for the bonds as noted below:

Table 45

Interest Rate Swap - Synthetic Fixed Rate	Terms	Rates
Fixed Rate to Counterparty	Fixed	5.30%
Variable Rate from Counterparty	1 month LIBOR	(5.33)%
Net Interest Rate Swap Payments		(0.03)%
Average Auction Rate Bond Coupon Payments		5.23%
Synthetic Interest Rate on Bonds		5.20%

2. Fair Value

As of June 30, 2006 the swaps had a mark to market fair value of $21.9 million. The mid-market or indicative unwind valuation was derived from a proprietary model using the zero coupon method. This model takes into consideration estimates about relevant present and future market consideration as well as the size and liquidity of the position and any related actual or potential hedging transaction.

The primary risks associated with this transaction are: Credit Risk, Termination Risk, and Basis Risk.

3. Credit Risk

As of June 30, 2006 the County was exposed to credit risk because the swap had a positive mark to market fair value of $21.9 million. Citibank is rated Aa1/AA/AA+ by Moody's, Standard & Poors and Fitch, respectively and Morgan Stanley is rated Aa3/A+/AA- by Moody's, Standard & Poor's and Fitch, respectively. Pursuant to the Agreement if the rating issued by Standard & Poors or Moody's of the senior unsecured debt obligations of the counterparties is suspended or withdrawn or falls below "A-" in the case of Standard & Poors or below "A3" in the case of Moody's, collateral is to be delivered to a third party.

(Amounts Expressed in Thousands Unless Otherwise Noted)

4. Termination Risk

The Agreement includes standard termination events such as failure to pay, bankruptcy and early termination. For this transaction, the swap and bond maturities match and carries an Interest Rate Swap Insurance Policy by MBIA Insurance Corporation (MBIA). If the Agreement is terminated for any of the conditions in the agreement, and at the time of the termination the swap has a negative fair value, the County would be liable to the counterparties for a payment equal to the swap's fair value. The swap can be terminated by the County for market value at any time. As of June 30, 2006 the fair value of the swap is $21.9 million. Value is predominantly tied to changes in the market for the fixed swap rate for the remaining swap term.

5. Basis Risk

The County's exposure to basis risk arises when the one-month LIBOR rate index received from the counterparties may be less than the applicable auction rate that is being paid to the bondholders, that is the cash flow being received by the counterparty is not equal to the cash flow being paid to the variable rate bondholder. By using one month LIBOR, the County's objective is to mitigate the effect of the differential between the swap index and the bondholder variable rate. For fiscal year 2006, the differential was $375 thousand.

6. Swap Payments and Associated Debt

As of June 30, 2006, debt service requirements of the variable-rate debt and net swap payments, *assuming current interest rates remain the same*, for their term are presented in **Table 46**. As rates vary, variable rate bond interest payments and net swap payments will vary.

Table 46

Interest Rate Swap - Basis Risk

Fiscal Year Ending June 30	Principal	Interest 5.23%	Interest Rates Swaps, Net (.03%)	Total
2007	$	21,188	(122)	$ 21,066
2008		21,188	(122)	21,066
2009		21,188	(122)	21,066
2010		21,188	(122)	21,066
2011		21,188	(122)	21,066
2012-2016		105,940	(608)	105,332
2017-2021	102,450	93,140	(534)	195,056
2022-2026	135,475	62,227	(357)	197,345
2027-2031	167,200	21,647	(124)	188,723
Total	$ 405,125	388,894	(2,233)	$ 791,786

K. Landfill Site Closure and Postclosure Care Costs

State laws and regulations require the placement of final covers on all landfill sites that stopped accepting solid waste after October 9, 1991 and the performance of certain maintenance and monitoring functions at these sites for a minimum of 30 years after closure. Closure and postclosure care costs are paid near or after the date a landfill stops accepting waste. The San Marcos Landfill is the sole waste disposal site owned by the County that is subject to these regulations. It was operational and accepted solid waste from 1979 until March 11, 1997. Formal approval from the regulatory agencies for the closure of this landfill is anticipated to be received by March 2007.

The County is required by GASB Statement No. 18, "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs", to report the projected closure and postclosure care costs as of each balance sheet date. The projected landfill closure and postclosure care liability at June 30, 2006 for the San Marcos Landfill was $24.447 million. This estimated amount is based on what it would cost to perform all closure and postclosure care in calendar year 2006 dollars and is subject to change as a result of such factors including but not limited to: inflation; deflation;

(Amounts Expressed in Thousands Unless Otherwise Noted)

advancements in technology; and amendments to laws and regulations.

In addition to the above, state regulations require that landfill closure and postclosure maintenance costs be fully funded at the time of closure, unless a landfill owner/operator can demonstrate financial responsibility towards these activities by using other approved financial assurance alternatives. A pledge of revenue is one of various alternatives allowed to fund estimated postclosure costs. Under this alternative, the Board of Supervisors, on February 3, 1998, approved Minute Order No. 5 "Postclosure Maintenance Funding for the San Marcos Landfill", wherein the County entered into a pledge of revenue agreement with the California Integrated Waste Management Board (CIWMB). Pursuant to Resolution No. 98-24, adopted under Minute Order No. 5, the Board directed that the amount of pledged revenue shall be equal to $790 thousand per year for the 30 year period of postclosure maintenance commencing upon completion of the final closure of the San Marcos Landfill. The pledged amount is a promise of existing funds rather than future revenues and may increase or decrease to match any adjustment to identified cost estimates that are mutually agreed to by the County and the CIWMB.

As of June 30, 2006, $23.443 million has been spent on closure costs and $2.276 of the net assets of the government-wide statement of net assets has been restricted for remaining closure costs of the San Marcos Landfill.

Regulations governing solid waste management are promulgated by government agencies on the federal and state levels. These regulations address the design, construction, operation, maintenance, closure and postclosure maintenance of various types of facilities; acceptable and prohibited waste types; and inspection, permitting, environmental monitoring and solid waste recycling requirements. Regulations at both the state and federal levels could impose retroactive liability, particularly with respect to cleanup activities relating to any landfill site ever operated by the County, whether or not owned by the County. Thus, the County has potential liability with respect to every landfill ever owned, operated, contracted to be operated, or into which the County disposed waste. Compliance with these regulations may be costly, and, as more stringent standards are developed to protect the environment, these costs could increase.

L. Fund Balances Reserved For Other Purposes

At June 30, 2006, the fund balances reserved for other purposes are presented in **Table 47** as follows:

Table 47

Fund Balances Reserved For Other Purposes	
General Fund	
Defray administrative costs and other general related reserves	$ 19,959
Improvement and maintenance of recorded document systems	20,274
Teeter tax losses	9,858
Emergency medical services, and various construction related costs	10,385
Health, mental health	24,303
Social programs	2,534
Vector control	4,638
Real estate fraud prosecution	1,242
Domestic violence and child abuse prevention	5,229
Sheriff vehicle maintenance and replacement	1,542
Purchase and operation of fingerprinting equipment	4,774
Sheriff automated warrant system	3,008
Delinquency and juvenile crime prevention	2,174
Reserve for donations	2,997
Total General Fund	112,917
Special Revenue Funds	
Road-future road improvements	52,426
Lighting Maintenance	16
County Library projects	87
County Service Districts projects	1,366
Flood Control-future drainage improvements	16,626
Housing Authority-deposits with others	79
Tobacco Securitization - debt admin costs	230
Total Special Revenue Funds	70,830
Capital Projects Funds	
Edgemoor capital projects	250
Redevelopment Agency-prepaid items	825
Total Capital Projects	$ 1,075

(Amounts Expressed in Thousands Unless Otherwise Noted)

V. Other Information

A. Risk Management

The County operates a Risk Management Program, whereby it is self-insured for premises liability at medical facilities, medical malpractice, errors and omissions, false arrest, forgery, general liability and workers' compensation. The County purchases insurance for property damage, certain casualty claims, public officials bond, employee dishonesty, faithful performance, volunteers, airport comprehensive, and loss of money and securities based upon site locations. Settlements in the areas covered have not exceeded insurance coverage for each of the past three fiscal years. The County's Internal Service Fund (ISF) is used to report all of its uninsured risk management activities. Risk management liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Actuarial evaluations were obtained which determine estimates of known and projected public liability and workers compensation claim liabilities. At June 30, 2006, the amount of these liabilities, including an estimate for claims incurred but not reported and allocated and unallocated loss adjustment expenses was estimated at $122.3 million, including $31 million in public liability and $91.3 million in workers' compensation. Changes in the balances of claim liabilities for fiscal year 2005 and 2006 are shown below:

Table 48

Risk Management - Changes in Claim Liabilities			
		July 1	June 30
Unpaid Claims, Beginning of Year	$	97,789	103,569
Incurred Claims		42,968	52,908
Claim Payments		(37,188)	(34,145)
Unpaid Claims, End of Year	$	103,569	122,332

B. Subsequent Events

1. Tax and Revenue Anticipation Notes

In July 2006, the County issued tax and revenue anticipation notes (TRANS) totaling $220 million due July 27, 2007 at a coupon rate of 4.50% and net interest cost of 3.70%. Proceeds from the notes will be used to meet fiscal year 2007 cash flow requirements. Fiscal year 2007 unrestricted revenues collateralize the notes.

2. San Diego County Taxable Pension Obligation Bonds

In June of 2004, the County of San Diego issued $454.113 million of Taxable Pension Obligation Bonds consisting of Series A Current Interest Bonds in the amount of $241.360 million, Series B Auction Rate Securities in the amount of $147.825 million and Series C Public Income Notes (PINES) in the amount of $100.17 million (including $35.242 of unaccreted appreciation).

On August 15, 2006, the series 2004 B Auction Rate Securities in the amount of $147.825 million will be converted from auction rate securities to bonds bearing interest at fixed interest rates. Interest on the bonds will accrue at a fixed interest rate 5.911% payable semiannually on February 15 and August 15 of each year, commencing on February 15, 2007. Principal of $147.825 million will be payable on August 15, 2024.

C. Contingencies

1. Litigation

In addition to the accrued liability for litigation and workers compensation claims described in Note V-A, the County has a potential liability of $26.6 million that could result if unfavorable final decisions were rendered in numerous lawsuits to which the County is a named defendant. Appropriations are budgeted annually for those portions of obligations coming due that fiscal year. Estimates of potential liabilities described above (in Note V-A) include estimates of claims incurred but not reported at June 30, 2006.

2. Unrecorded Leave Benefits

County employees have unrecorded

accumulated benefits of approximately $139.3 million in sick leave and compensatory time. These benefits are not payable to employees upon termination and are normally liquidated in future years as employees elect to use their benefits as prescribed by Civil Service rules and regulations. Accumulated vacation, sick leave, and compensatory time-off for which employees are eligible for payment upon separation have been recorded as current or long-term liabilities in the appropriate proprietary funds and the statement of net assets.

3. Federal and State Programs

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the County expects such amounts, if any, to be immaterial.

D. Jointly Governed Organizations

The County Board of Supervisors jointly governs the Service Authority for Freeway Emergencies (S.A.F.E.). San Diego S.A.F.E. is governed by a seven-member board, whose members are appointed by the County Board of Supervisors and the eighteen cities within the county. The purpose of the authority is to provide for freeway emergency call boxes on major freeways within the County. Funding for the authority is provided by a $1dollar yearly fee on vehicle registrations in San Diego County, which are collected by the State and deposited into the County Treasury. The County provides minimal administrative staff support for the S.A.F.E. authority.

The County Board of Supervisors and the San Diego City Council jointly govern the San Diego Workforce Partnership (Partnership). The Partnership's Board of Directors consists of two members of the County Board of Supervisors, two members from the San Diego City Council and one member of a charitable organization. The purpose of the Partnership is to provide employment training to area residents. Funding for such training is provided by State and Federal grants.

The San Diego Geographic Information Source (SanGIS) was created in July 1997 as a joint powers agreement between the City of San Diego and the County of San Diego. SanGIS objectives are to create and maintain a geographic information system, marketing and licensing compiled digital geographic data and software, providing technical services and publishing geographic and land-related information. The annual budget of $1.5 million is funded by 50/50 split between the City and the County.

The County also jointly governs the San Dieguito River Valley Authority, the Serra Cooperative Library System, Southern California Regional Training and Development Center, and the Van Horn Regional Treatment Facility. The governing boards of these entities consist of representatives from the County and/or other regional governments and other counties. The County does not appoint a voting majority to the above boards. Services provided by these entities include park land acquisition, coordination of library services, regional governmental training, and treatment of emotionally disturbed youth.

E. Deferred Compensation Plans

- County of San Diego Incentive Retirement Deferred Compensation Plan

The County of San Diego Incentive Retirement Deferred Compensation Plan is a defined contribution plan established and governed under the Internal Revenue Code Section 401(a). All permanent and part-time County employees are eligible to participate in the plan. Participants may elect to contribute between 2.5 and 25% of their federal taxable gross wages, up to $44,000 a year, whichever is less. Plan participation is voluntary, however, once enrolled, the election percentage is irrevocable except under certain unforeseeable financial hardship provisions in the plan.

Under Internal Revenue Code rules, the amount of contributions by participants to the plan are considered employer contributions not subject to federal or state tax at the time of contribution. Participants direct the investment of all amounts contributed through two plan providers. All amounts held on behalf of participants are fully vested and held in trust at all times. Plan benefits for a participant who separates from County service or retires will be dependent upon the accumulated value of individual contributions and investment return. The County does not perform the investing function and has no fiduciary accountability for the plan. Thus, plan assets and any related liability to plan participants have been excluded from the County's financial statements.

The County's actual contributions for the year ended June 30, 2006 were $24.965 million.

- San Diego County Deferred Compensation Plan

The County offers to its employees an optional deferred compensation plan created in accordance with Section 457 (b) of the Internal Revenue Code. This plan is available to substantially all employees and allows participants to defer a portion of their current income until future years, up to a maximum of $15,000 (in whole dollars), so as to shelter such funds and earnings from state and federal taxation until withdrawal. The deferred compensation is not available to participants until termination, retirement, death, or unforeseeable emergency.

The County does not perform the investing function and has no fiduciary accountability for the plan. Thus, plan assets and any related liability to plan participants have been excluded from the County's financial statements.

F. San Diego County Employees Retirement System

1. Plan Description

The SDCERA administers a cost-sharing, multi-employer defined benefit plan, with County members representing 92.6% of covered employees, which provides retirement, disability, and death benefits for plan members and beneficiaries pursuant to the County Employees Retirement Act of 1937, as enacted and amended by the State legislature. The plan is integrated with the Federal Social Security System. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the SDCERA Board of Retirement. SDCERA issues a publicly available financial report that includes financial statements and required supplementary information for the pension plan. The financial report may be obtained by writing to the San Diego County Employees Retirement Association, 2275 Rio Bonito Way Suite 200, San Diego, California 92108 or by calling (619) 515-0130.

2. Basis of Accounting, Estimates and Fair Value of Investments

a. Measurement Focus and Basis of Accounting

SDCERA's operations are accounted for on an economic resources measurement focus and the accrual basis of accounting. Employer and member contributions are recognized when due pursuant to formal commitments, as well as statutory or contractual requirements. Investment income is recognized as revenue when earned. Retirement benefits and refunds are recognized when due and payable in accordance with the terms of the Plan. Other expenses are recognized when the corresponding liabilities are incurred. The net appreciation/(depreciation) in fair value of investments held by SDCERA is recorded as an increase/(decrease) to investment income based on the valuation of investments.

(Amounts Expressed in Thousands Unless Otherwise Noted)

b. Estimates

A number of estimates and assumptions have been made relating to the reporting of assets and liabilities, the disclosure of reserves and designation of plan assets to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

c. Fair Value of Investments

Please refer to details contained in Note IV. A. 2. b. (IV Detailed Notes on all Funds; A. Deposits and Investments; 2. Investments Outside the Pool; b. Pension Trust Fund.)

3. Funding Policy

State statutes require member contributions to be actuarially determined to provide a specific statutory level of benefit. Member contribution rates, as a percentage of salary, vary according to age at entry, benefit tier level, and certain negotiated contracts which provide for the County to pay a portion of the employees' contribution. Member contribution rates (weighted average), in effect at June 30, 2006, expressed as a percentage of salary are 9.06%-9.46% for general members and 11.28% for safety members. The County is also required by State statutes to contribute at an actuarially determined rate, expressed as a percentage of annual covered payroll. The fiscal year 2006 rates, expressed as a percentage of covered payroll, are 21.34% for general members and 29.19% for safety members. Additionally, in accordance with various agreements with employee bargaining units, the County has contributed $41.2 million on behalf of employees.

In March 2002, the County implemented a new enhanced retirement package. In October 2002, the County issued taxable Pension Obligation Bonds to fund a portion of its statutory obligations arising from enhanced benefits. In June 2004, the County issued Pension Obligation Bonds and transferred $450 million of the issuance to the retirement fund. The retirement plan's funding status (the ratio of system assets to system liabilities) was 83.6% at June 30, 2006.

4. Annual Pension Cost

For the fiscal year ended June 30, 2006, the County's annual pension cost was $203.7 million. The County's actual contribution during the fiscal year ended June 30, 2006 totaled $203.7 million, resulting in a net pension obligation of zero as of June 30, 2006, compared to zero at the end of the prior year. The required contribution rates, as adopted by the SDCERA Board, were determined as part of the June 30, 2003 interim actuarial valuation based on entry-age actuarial cost method. The actuarial assumptions included (a) an 8.25% investment rate-of-return, (b) projected salary increases of 5.0% per year, and (c) cost-of-living increases for retirees of 3%.

5. Three-Year Trend Information

The following trend information concerning annual pension costs and the percentage of annual pension costs contributed for the last three fiscal years is included below:

Table 49

Three-Year Trend Information

Fiscal Year Ended June 30	Annual Required Contributions	Percentage of ARC Contributed	Net Pension Obligation
2004	$ 194,580	100.00%	$ 0
2005	235,122	100.00%	0
2006	$ 203,700	100.00%	$ 0

6. Retiree Health Benefits

Retiree health benefits may be available to eligible retirees to the extent that the Board of Retirement annually approves the payment of such benefits. SDCERA recognizes the cost of providing those benefits by expending annual insurance premiums, which approximated $32.9 million for fiscal year 2006.

(Amounts Expressed in Thousands Unless Otherwise Noted)

The Board of Supervisors and the Board of Retirement adopted a funding mechanism under Section 401(h) of the Internal Revenue Code, which calls for a portion of the County's contributions to be deposited to a separate health benefits 401(h) account each year. Any investment income earned on the account balance increases the balance and any losses reduce it.

The reserve for health benefits, established by the SDCERA Board of Directors, designates funds that may be used for future payments under the retiree health benefits program and related administrative expenses. The reserve for health benefits was approximately $207.3 million at June 30, 2006, a $13.5 million increase from the previous fiscal year.

G. Restatement of Beginning Net Assets Balance

1. First 5 Commission

The beginning net asset balance of the First 5 Commission was restated as shown in **Table 50** below in the amount of $1.419 million resulting from 1) An adjustment of prior year mark to market unrealized loss of $1.307 million and 2) entries to correct the treatment of vacation accrual of $112 thousand.

Table 50

Restatement		
Net Asset balance as of June 30, 2005	$	175,946
Adjustment for restatement		1,419
Net Asset balance, restated June 30, 2005	$	177,365

H. Commitments

1. Third Party Debt

The tax code allows for certain types of nongovernmental borrowers to take advantage of tax-exempt financing through a governmental agency. The County of San Diego as a governmental agency, has issued tax-exempt debt on behalf of qualified borrowers. The County of San Diego is not responsible for the repayment of the debt. Accordingly, no liability for these bonds has been recorded in the statement of net assets.

a. Mortgage Revenue Bonds

Mortgage Revenue Bonds are issued to provide construction and permanent financing to developers of multi-family residential rental projects located in the County to be partially occupied by persons of low or moderate income. Between 1995 and 2002, the County issued $14 million of Mortgage Revenue Bonds of which $11.89 million were still outstanding as of June 30, 2006.

b. Certificates of Participation

The County has implemented a conduit program whereby the County is the issuer of tax-exempt bonds and loans, where the proceeds are provided to a qualifying for profit or nonprofit organization. The County has no obligation to pay for the bonds and loans. The original amounts of Certificates of Participation issued as well as the amounts outstanding per issue at June 30, 2006 are as follows:

Table 51

Certificates of Participation - Conduit Program	Date Issued	Original Amount Issued	Amount Outstanding at June 30
Sharp Hospital	April 1998	$ 112,020	$ 98,970
San Diego Natural History Museum	December 1998	15,000	13,500
San Diego Museum of Art (principal due at maturity)	March 2000	6,000	6,000
Salk Institute	April 2000	15,000	14,050
University of San Diego	May 2001	36,870	33,230
San Diego-Imperial Counties Developmental Services	September 2002	10,750	10,000
Chabad Jewish Academy (principal due at maturity)	January 2003	11,700	10,820
San Diego Jewish Academy (principal due at maturity)	December 2003	13,325	12,255
Bishop School	June 2004	25,000	25,000
Museum of Contemporary Art	December 2004	13,000	13,000
Sidney Kimmel Cancer Center (principal due at maturity)	September 2005	24,500	24,500
Burnham Institute for Medical Research	February 2006	59,405	59,405
Total		$ 342,570	$ 320,730

c. Reassessment District Improvement Bonds

Reassessment District Improvement Bonds were issued to provide refunding an earlier issuance of improvement bonds for the 4-S Ranch assessment district. The District originally issued $28.8 million of Improvement Bonds in July 1991 to finance the acquisition of certain infrastructure improvements specially benefiting properties within an assessment district. In July 1997, the District issued $21.8 million of Reassessment Bonds to refund the original issuance, of which $11.87 million were still outstanding as of June 30, 2006.

2. Deposits for Other Agencies

The Treasurer is a named paying agent for various bonds issued by other agencies, e.g., school districts, pursuant to the bond covenants. The proceeds from these issues are deposited in the County pool or as specified in the bond resolution. The amounts deposited belong to the specific agency which issued the bonds and are not assets of the County. The County has no liability with respect to these issues, the repayment of these bonds are from ad valorem taxes levied on the properties in the school district.

I. New Governmental Accounting Standards

1. Implemented

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.* This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section-an amendment of NCGA Statement 1.* This statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles* that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement adds new information that financial statement users have identified as important and eliminates certain previous requirements.

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation - an amendment of GASB Statement No. 34*. This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. A legally enforceable enabling legislation restriction is one that a party external to the County - such as citizens, public interest groups, or the judiciary - can compel a government to honor.

In June 2005, GASB issued Statement 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. This Statement requires employers to disclose a description of the termination benefit arrangement, the cost of the termination benefits (required in the period in which the employer becomes obligated if that information is not otherwise identifiable from information displayed on the face of the financial statements), and significant methods and assumptions used to determine termination benefit liabilities. For termination benefits other than those provided through an existing defined OPEB plan, this Statement was effective for the County's fiscal year ending June 30, 2006.

The County has analyzed its accounting practices to determine the potential impact on the financial statements for the GASB Technical Bulletin No. 2006-1 *Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D.* This Technical Bulletin clarifies the application of existing standards of accounting and financial reporting to payments that an employer or a defined benefit other postemployment benefit (OPEB) plan receives from the federal government pursuant to the retiree drug subsidy provisions of Medicare Part D, as established in the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. It was determined that this Bulletin has no impact on the financial statements.

In Fiscal Year 2006, the County implemented these new reporting requirements.

2. Under Analysis

The County is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans.* This statement establishes uniform financial reporting standards for other postemployment benefits (OPEB) plans. The approach followed in this statement generally is consistent with the approach adopted for defined benefit pension plans with modifications to reflect differences between pension plans and OPEB plans. The statement applies for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. This statement is effective for the County's fiscal year ending June 30, 2007.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. This statement's provisions may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. This statement is effective for the County's fiscal year ending June 30, 2008.

In June 2005, GASB issued Statement 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45, and are therefore effective for the County's fiscal year ended June 30, 2008.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. Governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments - generally, a single lump sum. The financial reporting question addressed by this Statement is whether that transaction should be regarded as a sale or as a collateralized borrowing resulting in a liability. This statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. This statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. Additionally, this statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. This disclosures pertaining to future revenues that have been pledged or sold are intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. This statement is effective for the County's fiscal year ending June 30, 2008.

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.* This Statement identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements. This statement is effective for the County's fiscal year ending June 30, 2009.