



# County of San Diego

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Honorable Members of the Board of Supervisors  
County of San Diego  
San Diego County Administration Center  
San Diego, California, 92101

Ladies and Gentlemen:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the County of San Diego, California (the County) for the fiscal year ended June 30, 2002 with the Independent Auditors' Report, submitted in compliance with California Government Code Section 25253. The Chief Financial Officer/ Auditor and Controller's office has prepared the CAFR in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the County. I believe that the data, as presented, is accurate in all material respects; that its presentation fairly shows the financial position and the results of the County's operations as measured by the financial activity of its various funds; and that the included disclosures will provide the reader with an understanding of the County's financial affairs.

This is the first year the County prepared the CAFR using the new financial reporting requirements as prescribed by the GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB 34). This new GASB Statement requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management's Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

Our CAFR is divided into the following sections:

**The Introductory Section** includes information about County government, the County's economy, general management system, strategic initiatives, selected other financial information, and acknowledgements.

**The Financial Section** is prepared in accordance with the GASB 34 requirements by including the MD&A, the Basic Financial Statements including notes and the Required Supplementary Information. The Basic Financial Statements include the government-wide financial statements that present an overview of the County's entire financial operations and the fund financial statements that present the financial information of each of the County's major funds, as well as non-major governmental, fiduciary, and other funds. Also included in this section is the Independent Auditors' Report on the financial statements and schedules.

**The Statistical Section** provides trend data and non-financial information useful in assessing the County's financial condition. In this regard, it contains various tables, which present ten years of historical information concerning financial data, debt statistics, and miscellaneous social and economic data. This information is often of special interest to potential investors, creditors and other interested readers.

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## **SAN DIEGO COUNTY PROFILE**

The San Diego County is the southernmost major metropolitan area in the State of California and covers 4,255 square miles, extending 70 miles along the Pacific Coast from Mexico to Orange County, and inland 75 miles to Imperial County along the international border shared with Mexico. Riverside and Orange counties form the northern boundary. The County enjoys a wide variety of climate and terrain, from coastal plains and fertile inland valleys to mountain ranges and the Anza-Borrego Desert in the east. The Cleveland National Forest occupies much of the interior portion of the County. The climate is equitable in the coastal and valley regions where most resources and population are located. The average annual rainfall in the coastal areas is 10 inches, so that the County is highly dependent on imported water.

The County population in January 2002 was estimated to be 2,918,300, an increase of 2% over January 2001, making it the third largest county by population in California and the sixteenth largest Metropolitan Statistical Area in the United States. Between 1970 and 1995, the San Diego region's population growth outpaced both the state and the nation, according to the San Diego Association of Governments (SANDAG), who projects that trend to continue through 2020. There are 18 incorporated cities in the County; of them, the City of San Diego is the largest, with population of approximately 1.25 million. In addition, Tijuana, Mexico, with an estimated population of 1.2 million, is a substantial urban neighbor with a shared border, workforce, and economy.

The racial and ethnic composition of the County is as diverse as its geography. According to SANDAG's analysis of the 2000 Census, 55% of the population is White; 27%, Hispanic; 9%, Asian; 5%, Black; and 4%, all other groups. The growth in the Hispanic population over the last 10 years, 47%, has significantly exceeded total County population growth of 13%. SANDAG projects that both the Hispanic and Asian population shares will continue to increase through 2020. SANDAG also projects an older San Diego County by 2020, based on statistics such as median age and rate of increase of populations over 65.

## **COUNTY GOVERNMENT, ECONOMY AND OUTLOOK**

### **San Diego County Government**

The County was incorporated on February 18, 1850, and functions under a charter adopted in 1933, as subsequently amended from time to time. A five-member Board of Supervisors elected to four-year terms in district nonpartisan elections governs the County. The Board of Supervisors appoints the Chief Administrative Officer and the County Counsel. The Chief Administrative Officer appoints the Chief Financial Officer. Elected officials include the Assessor/Recorder/ County Clerk, District Attorney, Sheriff and Treasurer-Tax Collector.

Many of the County's functions are required under County ordinances or by state or federal mandate, as County government is the delivery system for federal, state and local programs. The County supports a wide range of services to its residents including regional services such as courts and elections, public health and welfare, and environmental services. The County also provides the unincorporated areas public safety, basic community services such as planning and parks, and infrastructure such as roads and waste disposal. State and federally mandated programs, primarily in the social and health services areas, are directed to be maintained at certain minimum levels, with eligible costs subject to reimbursement according to specific guidelines; however, not all mandated costs are reimbursed.

### **San Diego Economy**

In 2002, Forbes Magazine recognized San Diego as the "Best Place" for business and careers, citing a diversified economy and skilled labor force. In recent years the County has enjoyed economic stability, outpacing the state economy despite a general recession in California. For example, the unemployment rate for the County has been lower than that of the State for the last 5 years, and at July 2002 was 4.2% as compared to 6.6% for the State. Much of this economic strength was characterized by outstanding employment gains, personal income increases, rising levels of commercial and industrial development and steady population growth. Looking forward, the state and federal economies are expected to grow slowly, with increases in business investment and slow growth in consumer spending. The San Diego economy is expected to perform in line with the slow expansion of the state and federal economies and to maintain its favorable position in relation to such comparative statistics as unemployment and job growth.

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The County's economic base consists of a significant manufacturing presence in the fields of electronics and shipbuilding, a large tourist industry attracted by the favorable climate of the region, and a considerable defense-related presence which contributes approximately \$10 Billion annually to the retail and service businesses of the area. Highlights of County employment as of July 2002 are listed below.

- Non-agricultural employment totaled 1,238,000 jobs.
- The services industry constitutes the largest employment sector and accounted for approximately 34.2% of nonagricultural employment as of July 2002, with a total of 424,000 employed.
- The wholesale and retail trade industries were the second largest sector, comprising approximately 22.5% of non-agricultural employment with a total of 278,100 jobs.
- Government accounted for approximately 16.8% of total employment and manufacturing accounted for an additional 10.3%. The U.S. Department of Defense contributes about \$10 billion annually to the local economy, through wages paid to the uniformed military and civilian personnel, and for equipment and services purchased from local businesses. San Diego's military presence is anticipated to remain relatively stable and may even increase due to the consolidation of military operations and facilities. The potential effects of military buildup during the War on Terrorism are uncertain. Although the increase in spending overall may benefit the local economy, events such as rapid troop deployment can cause economic fluctuations in segments such as apartment vacancies.
- Agriculture accounted for approximately .91% of total employment. During FY 2001-02, the United States Department of Agriculture ("USDA") named San Diego County as a primary disaster area due to wind, fire and drought conditions. This designation allowed farmers and ranchers in the County to be immediately eligible for USDA emergency loans.
- The construction and transportation sectors of employment are greatly influenced by the general health of the economy due to the fact that they serve the local market exclusively. The construction industry in particular has a significant multiplier effect on the economy as a whole. These two sectors are therefore directly influenced by the growth of population and housing.
- Employment growth over the next year is expected to come from the software and computer services and business services industries. Overall, the San Diego economy in 2003 is expected to add approximately 22,000 jobs, down slightly from 2002.

County revenues based on the local economy such as property taxes, sales taxes, and charges for services have benefited from the region's strength. For example, new real estate construction plus active resale markets over the last 5 years have resulted in an increase of 40% in the assessed value of property subject to property taxes (net of exemptions). Going forward, real estate markets are expected to remain strong but not spectacular. In addition to conditions of demand and supply, real estate market activity is also affected by interest rates, which are expected to remain low over the near term.

The difficult side of accelerating property values is that housing has become less affordable for San Diegans; the update of the County General Plan 2020 is in the process of providing land use and zoning regulations to accommodate expected population growth. Transportation demands and traffic congestion will affect the current and future quality of life, given suburban residential growth and business expansion, such as the gaming industry, outside city centers on formerly rural and agricultural land.

#### **GENERAL MANAGEMENT SYSTEM**

On April 21, 1998, the Board of Supervisors accepted the General Management System (GMS) as the formal comprehensive guide for planning, implementing, monitoring and rewarding all functions and processes of County Government that affect the delivery of services to our residents. The GMS establishes good business practices and discipline, both of which are essential to achieve the County of San Diego's vision.

The purpose of having a General Management System is to optimize efficient application of resources. These resources include not just taxpayer dollars, but all San Diego County assets, including our unique natural and cultural resources, the expertise and creativity of County employees, and the informed interest of County residents.

The idea behind the GMS is straightforward: the County will be able to provide superior services if we set sound goals and apply strong management principles to achieve those goals.

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Our County has an annual budget of more than \$3.8 billion and roughly 19,900 employees who serve nearly three million residents spread over more than 4,000 square miles. Coordination, fiscal and operational discipline, and shared commitment are vital. The GMS facilitates and organizes the goal setting process. GMS then links goal setting – long-range planning and resource allocation – to goal attainment, which includes monitoring, evaluation, cooperation, motivation, and recognition. The GMS helps ensure that County employees adhere to core principles, promoting a culture that values our employees, partners, and customers and institutionalizes continuous improvement and innovation.

The GMS process begins with long-range, five-year Strategic Planning. This is followed by short-term, two-year Operational Planning, which encompasses the budget process. Monitoring and control takes place throughout the year. Evaluation mechanisms are used to ensure that goals are tracked, plans followed, and risks identified. Functional threading maximizes efficient use of personnel and material resources by coordinating staff and linking the functions they perform. Motivation, rewards, and recognition encourages continuing progress by rewarding those who meet and exceed goals. The system completes a full circle in a fiscal year and begins again with a review of the Strategic Plan and development of a new Operational Plan.

County management defines and communicates GMS objectives. Lines of authority flow from the Board of Supervisors to the Chief Administrative Officer (CAO), Assistant CAO (ACAO), and the five Group General Managers/Deputy CAOs. These senior managers supervise appointed Department Heads, from whom authority flows down to line staff. Despite the crucial role of management, successful GMS application depends on strong and effective leadership at all levels of County service. Every County employee is expected to help set goals, strive to achieve them, and be rewarded for achievement.

The GMS helps ensure that sound planning, preparedness, and improvement become permanent organizational ethics. With the GMS as a guide, the County continues to use strong fiscal management practices, while remaining focused on providing superior services to County residents. The principles and procedures outlined by the GMS are meant to apply to every County function on an ongoing basis.

## **STRATEGIC INITIATIVES AND ACHIEVEMENTS**

Two external events of the last year strongly overlaid all areas of County activities and are expected to remain risk factors going forward. First, the terrorist attacks and ensuing War on Terrorism have colored forever the criticality of core government functions such as preparedness and safety. Second, the substantial state budget shortfalls are expected to extend across several years and to result in significant cuts to local government support with or without corresponding cuts in mandated services. Even with resources re-allocated in response to those two events, the County nevertheless made progress on all elements of its Strategic Plan.

### ***Provide for the Safety and Well-Being of County Residents***

Special emphasis on children and youth programs resulted in improvements to foster care and adoption programs. The San Pasqual Academy, a residential-educational campus for foster youth, opened with a focus to help foster youth obtain education and life skills in the absence of a traditional family structure.

The County is committed to improving the health safety net for residents by expanding both services and improving access thereto. Web-based technology was used to reach out to families eligible for Medi-Cal and more than 6,600 families were approved for health coverage through the new system. County Medical Services for health care were expanded by almost 9% and the County initiated a pilot project to help small businesses provide health care for employees.

Helping residents become or remain self-sufficient is another County commitment.

- County welfare caseload has dropped 56% since 1995, exceeding the statewide goal of 41%.
- In order to provide quality care to seniors and persons with disabilities, the County created a Public Authority for In-Home Supportive Services, which employs and provides health benefits to caregivers.
- Using a combination of financing techniques, including the sale of surplus adjacent property, the County initiated plans for the replacement of Edgemoor Hospital.

Public safety encompasses many areas of County activities, from law enforcement to food safety inspections. During the year these diverse functions responded to the new threats of terrorism and bioterrorism while maintaining their traditional oversight roles.

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- The County led the State in implementing the Substance Abuse and Crime Prevention Act (Prop 36), which mandates treatment instead of Jail time. The State now uses the County as a model for training other counties in Prop 36 implementation.
  - Domestic Violence Response Teams expanded to cover the entire County, pairing law enforcement with child and victim advocates.
  - Construction of the East Mesa Juvenile Detention Facility commenced in response to the region's growing juvenile justice caseload.

#### ***Preserve and Enhance the Environment***

County environmental programs focus on both planning and enforcement to maintain the elements of the physical environment—land, water, and air.

- The General Plan 2020 progressed during the year, with 250 public meetings to provide input to an updated community plan that balances regional preservation with housing and economic development needs.
- A related effort is County government's leadership in the Clean Water Project, which brings together all parties with a role in maintaining the quality and consistency of the local waters.
- The County achieved the Federal one-hour ozone standard in November 2001.

The Multi-Species Conservation Plan (MSCP) is the most ambitious habitat protection plan in the U. S. Since the MSCP was adopted in 1997, the County has acquired or protected over 84,000 acres of sensitive lands, achieving 85% of the program's goal in the first five years of a ten-year program.

#### ***Ensure the County's Fiscal Stability***

The County has enhanced its culture of strong fiscal discipline and preparedness to embrace an innovative approach to planning and problem solving. That culture will continue to be challenged by the continuing State budget deficit and its resolution.

One of the cornerstones of County financial management is the use of one-time funds for one-time expenditures, and last year one-time funds were used to retire early long-term debt used in the construction of County facilities. In a transaction that has won a number of governmental awards, the securitization of the County's share of the settlement from tobacco industry litigation has provided a substantial endowment to fund future health care independent of the consumption of tobacco products. The ratings on the various components of this specialized bond financing ranged from A1 to BBB by Standard & Poor's Rating Services, a division of the McGraw-Hill Companies, Inc. ("S&P"). In addition, S&P affirmed the County's "AA" rating during the year.

The County's response to last year's energy crisis is an example of fiscal discipline at the operational level. The County embarked on a program of conservation through demand management and modernization, exceeding its 10% energy-reduction goal by cutting energy costs by 13.9%.

#### ***Promote a Culture that Values our Employees, Partners, and Customers***

Employees are the key to providing quality services to residents. County government considers investment in its human resources to be as important as investment in infrastructure and has implemented enhancements in the areas of compensation and benefits in recent years designed to attract and retain employees. First, FY 2001-02 was the first year of five-year labor agreements that were reached with employee organizations, locking in increases for the County's largest expenditure item. Next, enhanced pension benefits were implemented. The County continues to stress results-oriented management, encouraging employees and managers to identify new ideas, reduce costs, and increase productivity.

#### ***Institutionalize Continuous Improvement and Innovation***

The first phase of the Enterprise Resource Planning applications, PeopleSoft, was implemented. This software is helping to transform the human resources systems, including processing time and information improvements. Other technology advances include a new telephone system and new case management systems in many departments.

Web technology has also led the way for better services, such as on-line auctions, maps from the geographic information system, and wedding broadcasts over the Internet.

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## **OTHER FINANCIAL INFORMATION**

### **Internal Controls**

In developing and evaluating the County's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within the above framework. We believe that the County's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

### **Strategic and Operational Planning (Budgetary) Process**

A 5-year Strategic Plan is updated annually to provide long-term direction to County managers and staff. It embodies the tenets of County's General Management System (GMS) and is built on mutually held expectations for the future. Each fiscal year a two-year Operational Plan is prepared and details each Department's strategic objectives and the resources required to achieve them. The Operational Plan is monitored regularly and is linked to the GMS system of rewards and recognition. The annual Line-Item Budget incorporates the first year of the Operational Plan and is formally adopted by the Board of Supervisors pursuant to Government Code 29000.

### **Pension Trust Fund**

The San Diego Employees' Retirement Association ('SDCERA') is a contributory defined benefit plan established July 1, 1939, under provisions of the County Employees Retirement Law of 1937. The plan is integrated with the Social Security System and substantially all employees participate. As a result of this year's adoption of the enhanced retirement benefits, the County incurred an increased obligation pursuant to the Retirement Law as an unfunded accrued actuarial liability (UAAL) to the Association. As of January 31, 2002, the total estimated accrued unfunded liability from these additional benefits was approximately \$870.8 million. In September 2002 the County issued \$737.3 million in Pension Obligation Bonds ("POBs"). The proceeds were used to defease a portion of outstanding prior POBs and to fund a portion of the aforementioned UAAL. For further details concerning this transaction please refer to the Management Discussion and Analysis ("MD&A") and Note 5J to the Financial Statements.

### **Cash Management**

The Treasurer, at the delegation of the Board of Supervisors, directs the investment of available County cash, along with cash from other local agencies such as school districts. All deposits are commingled in a pooled investment fund (the "Pool") and are invested according to an investment policy whose objectives are safety of principal, liquidity, and a rate of return consistent with prudent management. At June 30, 2002, the average yield on investments was 2.82%.

### **Risk Management**

The County purchases insurance for property damage (including earthquake), certain casualty claims, public-officials bond, employee dishonesty, faithful performance, and other risks, and pays deductible amounts that vary with each type of insurance.

The County is self-insured for all other risks. The self-insurance activities and resources are accounted for in two Internal Service Funds ("ISFs"), with the exception noted below of excess workers compensation. Risk liability levels for both ISFs are determined by actuarial studies, and reserves are being funded over a multi-year period from the rate structures charged to the operating funds. The risk management ISFs are also discussed in Note 5B to the Financial Statements. The ISFs are:

- The Employee Benefits ISF, for all uninsured employee risk management activities. The County purchases insurance for workers' compensation in excess of \$1 million.
- The Public Liability ISF, for all uninsured public risk management activities, including claims arising from medical facilities, medical malpractice, false arrest, and general liability.

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**INDEPENDENT AUDIT**

County Charter Section 802 requires an annual of the audit of the County's accounts and financial transactions. The certified public accounting firm, KPMG LLP, has audited the accompanying basic financial statements compiled from these records. Their Independent Auditors' Report on the financial statements is presented in the Financial Section.

**CERTIFICATE OF ACHIEVEMENT**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2001. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. The CAFR must satisfy both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

**OTHER AWARDS AND RECOGNITIONS**

San Diego County ranked among the top four counties in the nation—and number one in California—in a study of government performance conducted by the Maxwell School of Citizenship and Public Affairs at Syracuse University in conjunction with Governing Magazine. The study of 40 large counties considered several areas of management, such as finance, human resources, and information technology. The study was published in the February 2002 edition of Governing Magazine.

Other recent recognitions of excellence include

- 2002 Grand Watchdog Award from the San Diego County Taxpayers Association for Securitization of Tobacco Revenues
- 2002 Watchdog Award from the San Diego County Taxpayers Association for the Utility Savings Program
- 2002 California State Association of Counties Challenge Award for San Pasqual Academy
- Best of Category/Fiscal Management 2002, National Association of Counties (NACo) for Securitization of Tobacco Revenues
- Best of Category/Personnel, Training, Benefits, 2002 NACo Achievement Award for Career Ladder from Clerical Support to Environmental Health Professional

**ACKNOWLEDGMENTS**

I would like to express my appreciation to the accounting staffs of County departments and the staff of the Chief Financial Officer/Auditor and Controller whose coordination, dedication and professionalism are responsible for the preparation of this report. I would also like to thank KPMG LLP for their professional support in the preparation of the CAFR. Lastly, I would also like to thank the members of the Board of Supervisors, the Chief Administrative Officer, Group/Agency General Managers and their staffs for using sound business practices while conducting the financial operations of the County.

Respectfully,



WILLIAM J. KELLY  
Chief Financial Officer