

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

This section of the County of San Diego's (County) annual financial report provides a narrative overview and analysis of the financial activities of the County for the year ended June 30, 2002. We hope that the information presented here, in conjunction with the Letter of Transmittal, provides you with a clearer picture of the County's overall financial status. Comparative financial data is not required in the first year of implementing the new financial reporting model, Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," ("GASB 34") and subsequent related GASB statements. In future years, when prior year information is available, a comparative analysis of government-wide data will be presented. Unless otherwise indicated, all amounts in this section are expressed in thousands of dollars.

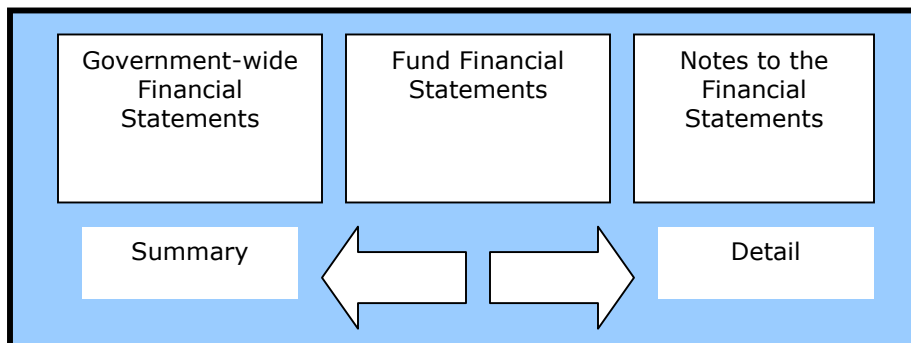
FINANCIAL HIGHLIGHTS

- The assets of the County exceeded liabilities at the close of the fiscal year 2001-02 by \$2.7 billion (*net assets*). Of this amount, \$316,404 (*unrestricted net assets*) may be used to meet ongoing obligations to citizens and creditors, \$182,640 is restricted for specific purpose (*restricted net assets*), and \$2.2 billion is invested in capital assets, net of related debt.
- The County's total net assets decreased by \$4,394.
- The County's total long-term debt at June 30, 2002 was \$1,448,066 equaling approximately 53 percent of total net assets (\$2.7 billion).
- General revenues, special items and transfers were \$1.1 billion. Of this amount, approximately 56 percent was attributable to state sales taxes and motor vehicle in lieu (\$605,175) while Property taxes accounted for approximately 38 percent (\$412,400).
- The net expense for governmental activities was \$1.1 billion. Public protection accounted for approximately 46 percent of this amount or \$497,341 while Health and sanitation accounted for 18 percent (\$196,162).
- At June 30, 2002, the General Fund's total fund balance was \$570,352. Of this amount, the unreserved-undesignated fund balance was \$234,582 or approximately 11 percent of total fiscal year 2001-02 expenditures (\$2.2 billion).

OVERVIEW OF THE FINANCIAL STATEMENTS

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

The illustration below depicts the required components of the basic financial statements.



MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Government-wide Financial Statements are designed to provide readers with a broad overview of County finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all County assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.

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

Both of these government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the County include general government, public protection, public ways and facilities, health and sanitation, public assistance, education, and recreational and cultural. The business-type activities of the County include airport operations, transit services, liquid waste and sanitation districts.

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

Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a county's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The County maintains 28 individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for the General Fund, the Tobacco Securitization Special Revenue Fund, and the Tobacco Securitization Corporation Debt Service Fund, all of which are considered to be major funds. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the Supplementary Information section in this report.

Proprietary funds are maintained two ways. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The County uses enterprise funds to account for the Airport, Transit, Liquid Waste and Sanitation Districts. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the County's various functions.

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Internal Service Funds are used to 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 General Services mail, printing and record storage 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. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The Airport, Liquid Waste, Transit, and Sanitation Districts are considered to be major funds of the County. The County's nine internal service funds are combined into a single, aggregated presentation in the proprietary funds financial statements. Individual fund data for the internal service funds is provided in the form of *combining statements* elsewhere in this report.

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

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information is presented concerning the County General Fund budgetary schedule, and SDCERA pension schedules. The County adopts an annual appropriated budget for its General Fund. A budgetary comparison schedule has been provided for the General Fund to demonstrate compliance with this budget. In addition, a budgetary comparison schedule has been provided for the Tobacco Securitization special revenue fund for it was determined to be a major governmental fund. The SDCERA pension schedules have been provided to present SDCERA's progress in funding its obligation to provide pension benefits to County employees. Required supplementary information can be found on pages 81, 89-90 of this report.

The combining and individual fund statements and schedules referred to earlier provide information for nonmajor governmental funds, enterprise and internal service funds and are presented immediately following the required supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Net Assets
June 30, 2002
(In Thousands)

	Governmental Activities	Business-type Activities	Total
Assets:			
Current and other assets	\$ 1,656,805	84,625	1,741,430
Capital assets	2,618,279	66,371	2,684,650
Total assets	4,275,084	150,996	4,426,080
Liabilities:			
Long-term liabilities outstanding	1,448,066	477	1,448,543
Other liabilities	226,728	5,847	232,575
Total liabilities	1,674,794	6,324	1,681,118
Net assets:			
Invested in capital assets, Net of related debt	2,178,892	66,026	2,244,918
Restricted	148,489	34,151	182,640
Unrestricted	271,909	44,495	316,404
Total net assets	\$ 2,599,290	144,672	2,743,962

Analysis of Net Assets

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the County, assets exceeded liabilities by \$2.7 billion at the close of fiscal year 2001-02. At the end of fiscal year 2001-02, the County had positive balances in all three categories of net assets.

The largest portion of the County's net assets (82 percent) reflects its investment of \$2.2 billion in capital assets (e.g. land, infrastructure, buildings, and equipment), less any related outstanding debt used to acquire those assets. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

Although the County's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be liquidated for these liabilities.

An additional portion of the County's net assets represents unrestricted net assets of \$316,404 (12 percent) that may be used to meet the government's ongoing obligations to citizens and creditors.

The remaining portion of the County's net assets, \$182,640 (7 percent) represents resources that are subject to external restrictions on how they may be used. External restrictions include those imposed by grantors, contributors, laws/regulations of other governments, or restrictions imposed by law through constitutional provisions or legislation, including those passed by the County itself.

Analysis of Changes in Net Assets

The County's net assets decreased by \$4,394 during the current fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Changes in Net Assets

June 30, 2002
(In Thousands)

	Governmental Activities	Business-type Activities	Total
Revenues			
Program revenues:			
Charges for services	\$ 380,996	42,345	423,341
Operating grants and contributions	1,168,086	5,763	1,173,849
Capital grants and contributions	30,128	501	30,629
General revenues:			
Property taxes	412,400		412,400
Interest	38,166	2,694	40,860
State sales tax and motor vehicle in lieu	605,175		605,175
Other	5,011		5,011
Total Revenues	2,639,962	51,303	2,691,265
Expenses:			
General government	170,908		170,908
Public protection	823,520		823,520
Public ways and facilities	168,202		168,202
Health and sanitation	547,200		547,200
Public assistance	825,028		825,028
Education	24,119		24,119
Recreational and cultural	18,021		18,021
Interest on long-term debt	68,771		68,771
Airports		7,973	7,973
Liquid Waste		3,808	3,808
Transit		17,085	17,085
Sanitation		15,306	15,306
Total expenses	2,645,769	44,172	2,689,941
Excess (deficiency) before special item, extraordinary item and transfers	(5,807)	7,131	1,324
Special item: gain on sale of properties	1,054	(5,145)	(4,091)
Transfers	359	(359)	
Increase in net assets	(4,394)	1,627	(2,767)
Net assets at beginning of year	2,603,684	143,045	2,746,729
Net assets at end of year	\$ 2,599,290	144,672	2,743,962

Governmental activities

Governmental activities decreased the County's net assets by \$5,807. This decrease was due to the inclusion of depreciation for infrastructure assets as required by GASB 34.

Revenue

The County's governmental activities rely on several sources of revenue to finance ongoing operations. Operating Grants and Contributions comprised the largest revenue source for the County followed by Charges for Services. Operating Grants and Contributions are monies received from parties outside the County and are generally restricted to one or more specific programs. Examples of Operating Grants and Contributions include State and Federal revenue for public assistance programs and for health and sanitation programs. Charges for Services are revenues that arise from charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided. Examples of the types of services that fall under this category include planning and engineering services, park and recreation fees, and law enforcement services provided to governmental agencies under contract. At the end of FY 2001-02, total revenue for the governmental activities including transfers from the business-type activities was approximately \$2.6 billion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Other factors concerning the finances of the County's major governmental funds are discussed in the Governmental Funds section of the "Financial Analysis of the County's Funds."

Expenses

Total expenses for governmental activities were \$2.6 billion. The majority of these expenses were spent for Public Assistance and Public Protection. Of the total expenses, approximately \$1 billion, or 40 percent, were ultimately financed by taxes.

Business-type Activities

Business-type activities increased the County's net assets by \$1,627.

Revenue

The County has four business-type activities: Airport, Liquid Waste, Transit and Sanitation. At June 30, 2002, the total revenues for the business-type activities were \$51,303. In keeping with the intent of recovering all or a significant portion of their costs through user fees and charges, business-type activities reported Charges for Services as their largest source of revenue. Operating Grants and Contributions as well as Capital Grants and Contributions were the other program revenue sources for the business-type activities.

Expenses

At the end of fiscal year 2001-02, the business-type activities reported total expenses including transfers to the governmental activities of \$44,531. The program revenues (Charges for services, Operating grants and contributions, and Capital grants and contributions) financed all the expenses recorded for the business-type activities.

Other factors concerning the finances of the County's enterprise funds are discussed in the Proprietary Funds section of the "Financial Analysis of the County's Funds."

FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

The County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

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

As of the end of the current fiscal year, the County's governmental funds reported combined ending fund balances of \$1.3 billion, an increase of \$310,075 in comparison with the prior year. Approximately \$855,138 of this total amount constitutes unreserved fund balance, which is available for spending at the County's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed, (1) to liquidate existing contracts and purchase orders (\$160,525), (2) for Inactive Landfill Maintenance (\$97,903), (3) to pay debt service (\$27,921), and (4) for a variety of other purposes (\$180,552).

GENERAL FUND

The General Fund is the chief operating fund of the County. At the end of the current fiscal year, the unreserved fund balance of the General Fund was \$355,155, while total fund balance was \$570,352, a decrease of \$47,932 from fiscal year 2000-01. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 16 percent of total General Fund expenditures of \$2.2 billion, while total fund balance represents 25 percent of that same amount.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

The following are examples of the factors that contributed to the change in fund balance for the General Fund in fiscal year 2001-02:

Revenue:

Licenses Permits & Franchises

This increase is due to an additional \$2.5 million in Franchise fees from Sempra Energy Company in calendar year 2001 recorded in fiscal year 2001-02. Additionally, the Licenses, Permits & Franchises increase is attributed to fee increases and the addition of 42 new fees approved by the Board of Supervisors in the Environmental Health department.

Revenue and Use of Money

This decrease is the result of a decrease in interest earnings. The interest earnings rate in fiscal year 2000-01 averaged 6.34 percent and the fiscal year 2001-02 average dropped to 3.78 percent. Another contributing factor to this General Fund interest decrease was the reduction in the Tax and Revenue Anticipation Note Program (TRANS) borrowing in fiscal year 2001-02 (\$150 million) compared to what was borrowed in fiscal year 2000-01 (\$175 million). This resulted in less cash on hand to earn interest.

Intergovernmental Revenue

A primary contributor to the overall decrease in Intergovernmental Revenue was the operational change brought on by the implementation of GASB 33 and 34 statements. In fiscal year 2000-01, Realignment, Proposition 172 and other funding activity was either recorded in Trust funds and revenue was moved to the General Fund in various accounts as expenditures were incurred in the General Fund; or, it was recorded directly in the General Fund (Vehicle License Fee Realignment funding). Beginning in fiscal year 2001-02, Realignment, Proposition 172 and other funding activity was budgeted in Special Revenue Funds and revenues were transferred via "transfers" to the General Fund, causing transfers in to increase while revenues decreased.

Miscellaneous Revenues

In fiscal year 2001-02, the County began recognizing external contributions for capital projects resulting in a \$3.5 million increase in Miscellaneous Revenues. The County also received \$2.2 million of one-time revenue from the Federal Government Southwest Board Assistance Program in fiscal year 2001-02. Finally, Miscellaneous Revenue also increased by \$4.3 million in fiscal year 2001-02 due to traffic fine revenue (Senate Bill 12 and 612 Maddy funds).

Other Financing Sources

Other Financing Sources increased as a result of transfers in for Realignment (\$248.5 million), Proposition 172 (\$185.8 million), and Tobacco Securitization (\$27.2 million).

Expenditures:

Public Protection

The increase in Public Protection is due to increases in the Sheriff's Department, Probation, District Attorney, and Child Support Services in fiscal year 2001-02 compared to fiscal year 2000-01.

Sheriff

In the Sheriff's Department, the majority of the salary and benefit changes were due to negotiated salary and benefit increases and safety members' retirement costs paid by the County. Staff increases resulted in increased costs of just over \$5 million. Services and supplies increases were in several areas. The increase in vehicles was due to all vehicles having to be in an Internal Service Fund. The majority of Services and Supplies increase was carried over from fiscal year 2000-01 - rebudgeted Major Maintenance (\$5.2 million) and Jail Information Management System (\$4.5 million) and the Sheriff's Integrated Records Management System (\$1.7 million).

Probation Department

In the Probation Department, the salary increases are due to additional staff associated with the programs implemented by Crime Prevention Act of 2000 (Assembly Bill 1913 or AB1913), and the Substance Abuse Prevention Trust Fund (Proposition 36). Also, retirement costs increased by \$700,000. Services and supplies

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increased due to contracted services associated with AB1913 and \$5.9 million associated with increased information technology services due to the implementation of a new caseload management system - although only about \$1.8 million of this was spent in fiscal year 2001-02.

District Attorney and Child Support Services

For the District Attorney and Child Support Services, staffing costs increased as a result of temporary staff becoming permanent staff in the newly established Child Support Services Department. The Services and Supplies increase is due to mid-year adjustments for costs incurred in relation to the further growth of this new department.

Additionally, the District Attorney had increases for an Information Technology system (\$1.4 million), five hundred thousand dollars for major maintenance and about two hundred thousand dollars for space costs. Salary and benefits costs also increased due to the negotiated increases and safety members' retirement costs in fiscal year 2001-02.

Health and Sanitation

The increase in Health and Sanitation is due to increases in the Health Services area. Salaries & Benefits expenditures increased due to step increases and salary adjustments for existing staff, and for additional staff to monitor the implementation and operation of the Integrated Services to the Homeless Mentally Ill, Proposition 36, AB1913, Early and Periodic Screening, Diagnosis and Treatment and Therapeutic Behavioral Services (EPSDT/TBS), Children's Mental Health Services and to accommodate caseload growth for Adult Mental Health.

Services & Supplies expenditures increased due to the rise in costs of contracted and institutional services for Adult Mental Health and expansion of Children's Mental Health Services for SED (Aid for Severely Emotionally Disturbed Children) and foster care programs. Expenditures also increased due to the implementation of Proposition 36, AB1913, and the increased health promotion activities aimed at tobacco education (smoking prevention and cessation for both youth and adults and chronic disease prevention). Finally, expenditures increased related to HIV /AIDS Master Grant Testing Survey, and Advanced Life Support Services, California Healthcare for Indigents Program (CHIP) contracts, program enhancements in Tuberculosis, Immunizations, Sexually Transmitted Diseases and other health programs.

Recreational and Cultural

The increase in Recreational and Cultural services is attributed to an increase in Salaries and Benefits and Services and Supplies in the Department of Parks and Recreation. In fiscal year 2001-02, the department hired several new staff as part of the effort to increase monitoring and maintenance of environmental resources in open space and regional parks. Further, approximately \$1 million was distributed to the department from reserves for major maintenance projects in fiscal 2000-01, many of which were carried over into fiscal 2001-02.

TOBACCO SECURITIZATION SPECIAL REVENUE FUND

This is a new Special Revenue Fund established in fiscal year 2001-02 to account for the \$411 million (net of closing costs and reserve requirements) the County received from the Tobacco Securitization Debt Service Fund related to the sale of approximately 25 years of Tobacco Settlement revenue. The County will continue to invest these funds in investment products to maximize the sustained long-term use of these dollars.

TOBACCO SECURITIZATION CORPORATION DEBT SERVICE FUND

This is a new Debt Service Fund established in fiscal year 2001-02 to account for the \$411 million (net of closing costs and reserve requirements) long term debt proceeds received from the sale of approximately 25 years of Tobacco Settlement revenue and the subsequent transfer of \$411 million to the Tobacco Securitization Special Revenue Fund.

Proprietary Funds

The County's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. The proprietary funds financial statements provide separate information for the Airport, Liquid Waste, Transit and Sanitation Funds, all of which are considered to be major funds of the

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County. Conversely, the Internal Service Funds are combined into a single, aggregated presentation in the proprietary fund financial statements with the individual fund data provided in combining statements, which can be found in the Supplemental Information section of this report.

Airport

Changes in the Revenues and Expenses of the Airport Enterprise Fund may be explained as follows:

- Grant revenue increased due to additional revenue from the Federal Aviation Administration.
- Salaries and Benefits increased in fiscal year 2001-02 due to cost of living increases and increased benefits costs.

Liquid Waste

Changes in the Revenue and Expenditures of the Liquid Waste Enterprise Fund may be explained as follows:

- Charges for Services increased due to the addition of a new project in fiscal year 2001-02 San Pasqual and an increase in Sanitation District project costs and related fees.
- Equipment Rental expenses decreased due to fewer projects that required rental equipment.

Transit

Changes in the Revenues and Expenses of the Transit Enterprise Fund may be explained as follows:

- Charges for Services increased due to additional Grant funding received related to Transit operations costs.
- Contracted Services increased due to additional Transit operation program costs.

At the end of fiscal year 2001-02 the Board of Supervisors authorized the divestiture of the Transit System. See the basic financial statements for additional details.

Sanitation Districts

Changes in the Revenues and Expenses of the Sanitation Districts may be explained as follows:

- Charges for Services increased due to growth in the service area for the Spring Valley Sanitation District.
- Repairs and Maintenance also increased due to growth in the service area for the Spring Valley Sanitation District.

Fiduciary Funds

The County maintains fiduciary funds for the assets of the San Diego County Employees' Retirement Association (SDCERA, as a pension trust fund), an Investment Trust, and various Agency Funds. As of the end of fiscal year 2001-2002, the net assets of the Pension Trust Fund totaled \$3.5 billion, representing a decrease of \$283,287 in total net assets since June 30, 2001. The change is primarily related to decreases in the market value of the SDCERA's investments. The Investment Trust Fund's net assets totaled \$1.9 billion, with an increase in net assets of \$473,375, primarily resulting from an increase in Contributions on pooled investments due to new school bond issues, offset by an increase in Distribution from pooled investments relating to use of school bond moneys.

General Fund budgetary highlights

The County's final budget differs from the original budget in that it contains carry-forward appropriations for various programs and projects and other supplemental appropriations approved during the fiscal year. Specifically, in fiscal year 2001-02, carry-forward appropriations totaled \$90.3 million of which \$46 million was for Capital Projects that had been previously budgeted, but not completed, \$20.7 million was for Health and Human Services Agency contractual commitments and the remainder for various purchase orders and contracted services throughout the other County departments. Supplemental appropriations totaling \$228 million were approved during the year. Significant activities included new capital projects (\$26 million), aligning Health and Human Services program appropriations with State funding allocations (\$40 million), self sufficiency programs utilizing CalWORKS incentive funds (\$15.3 million), augmenting Management Reserves for future one-time projects (\$51.8 million), payments to employees for incentives earned through the County's Quality First program (\$22.3 million), maintenance of effort obligations for trial courts (\$6.7 million) and converting the Child Support Department's child support system to the new State-wide system (\$5.8 million).

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Differences between the final budget and actual expenditures (on a budgetary basis) resulted in a \$327.5 million decrease in total charges to appropriations. This is primarily due to the following factors:

- A decrease in expenditures by the Health and Human Services Agency of approximately \$113 million related to reduced need for aid payments, lower service requirements and delays in putting some contracts into service. However, these expenditure reductions are almost entirely offset by decreases in Federal and State subvention funds.
- A decrease in expenditures by various Departments within the Public Safety group of approximately \$14.7 million primarily due to fewer youth being sent to residential treatment, a delay in the implementation of the Synovations Case Management System and rescheduling of various major maintenance projects to fiscal year 2002-03.
- Savings of \$52.6 million in salaries and benefits due to staff turnover and vacant positions throughout County departments.
- A decrease in expenditures of approximately \$18.6 million in the General County Expenditures area resulting primarily from funds set aside for economic uncertainty and savings in ERP system payments.
- A decrease in expenditures in the Finance and General Government Group of \$21.1 million is primarily attributed to savings in debt service payments as a result of restructuring or retiring bonds. Also, spending was less than originally anticipated due to delayed implementation of various information technology projects.
- Management Reserves totaling \$65.9 million were not spent.
- The Contingency Reserve of \$11 million was not spent.

During the year, actual revenues were less than budgetary estimates by \$187 million. The majority of this amount is attributable to reduced expenditure levels in Health and Human Services, Probation and Child Support Services. However, General Purpose revenues (specifically property taxes, vehicle license fees, real property transfer tax and sales tax) exceeded budgeted amounts by \$32 million. The County also started the fiscal year with an unappropriated-undesignated fund balance of approximately \$134 million. Of this amount, \$105 million was appropriated during fiscal year 2001-02, leaving a balance of \$29 million. The net effect of the remaining undesignated fund balance, the receipt of actual revenues greater than estimates, combined with expenditures less than appropriations, resulted in a positive undesignated fund balance of \$234.6 million for fiscal year 2001-02.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2002, the County's capital assets for both the governmental and business-type activities amounted to \$2.7 billion net of accumulated depreciation. The investment in capital assets includes land, construction in progress, structures and improvements, equipment, and infrastructure (including roads, bridges, flood channels, and traffic signals). The following lists the significant expenditures for capital assets in FY 2001-02:

Governmental Activities

- \$9,100 for acquisition of real property at Santa Ysabel creek for the purposes of wildlife habitat preservation and restoration.
- \$8,305 for payments to the Information Technology Internal Service Fund for expenditures incurred related to the County's Enterprise Resource Planning project.
- \$7,783 for the renovations to the San Pasqual Academy. Total project estimated at \$14,900.

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- \$7,361 for acquisition of real property for the replacement of the Downtown Courthouse.
- \$5,157 towards the construction of the East Mesa Juvenile Detention Facility. Total project estimated at \$52,800.
- \$4,498 for in acquisitions for the Multiple Species Conservation Program.
- \$3,309 towards the construction of the Rancho San Diego Library. Total project estimated at \$5,100.
- \$2,726 towards the construction of the Valley Center Library. Total project estimated at \$4,400.
- \$2,424 towards the construction of the Assessor Recorder County Clerk building at the South Bay Regional Center. Total project estimated at \$3,496.
- \$2,205 towards the Kearny Mesa Assessor Recorder County Clerk building. Total project estimated at \$6,867.
- \$2,175 for the North County Regional Center Courthouse Annex Remodel. Total project estimated at \$5,350.

Business-Type Activities

- \$4,593 for Ramona Airport extension Runway/Lighting - FY 01/02 expenditures were to extend the Ramona Airport runway 1,000 feet and provide required lighting.
- In 1979, a joint powers agreement was entered into by 9 County Sanitation Districts for the construction and maintenance of an operation center known as the South County Liquid Waste Collection and Transmission Center (SCLWCTC). The cost of the SCLWCTC was allocated to and capitalized in each of the sanitation districts. In 2002, as a result of the new reporting requirements, management made the decision to consolidate and transfer the operation center costs of \$445 to the Liquid Waste Enterprise Fund in order to simplify the accounting and depreciation

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

Additional information about the County's capital assets can be found in the notes to basic financial statements.

Debt Administration

At June 30, 2002, the County had total long-term obligations outstanding of \$721 million and no outstanding general obligation bonds. Of this amount, \$434 million pertains to the issuance of Certificates of Participation, \$5 million pertains to third-party leases and \$283 million pertains to Pension Obligation Bonds.

During fiscal year 2001-02, the County’s total bonded debt decreased by approximately \$67 million, due to the pay down of scheduled principal payments, the early payoff of the 2000 San Pasqual Academy Certificates of Participation (\$6 million) and the early payoff of the 2001 Interim Justice Refunding Certificate of Participation (\$18 million).

The County’s credit ratings on its bonded program are as follows:

	Moody’s	Standard & Poor’s	Fitch IBCA, Duff & Phelps
Certificates of Participation	A1	AA-	AA-
Pension Obligation Bonds	Aa3	AA-	Not rated

MANAGEMENT’S DISCUSSION AND ANALYSIS (Unaudited)

In addition the County has an Issuer Credit Rating of AA2 from Moody’s and AA from Standard & Poor’s. These ratings reflect the County’s favorable general credit characteristics, which include a strong local economy, a sound financial position and a moderate debt profile. However, on October 2002, Moody’s placed a negative outlook on all California county debt (except San Francisco). This is a result of the State of California’s pending decision to divert revenue from local governments due to any budget shortfall.

Useful bond ratios to management, citizens, and investors are as follows:

	FY 2002	FY 2001
Net Bonded Debt	\$690,308	\$746,650
Net Bonded Debt per Capita	\$237	\$259
Ratio of Net Bonded Debt to Assessed Value	.32 percent	.38 percent

In March of 2002, the County implemented a new enhanced retirement package resulting in the increased unfunded accrued actuarial liability to the San Diego County Employees Retirement Association. In September 2002, the County issued \$737.3 million of taxable Pension Obligation Bonds to finance a portion of this liability.

Additional information in the County's long-term debt can be found in the notes to basic financial statements.

Economic factors and next year’s budget and rates

- The fiscal year 2002-03 budget utilized \$83.5 million out of the \$234.6 million in available undesignated fund balance. Fund balance is used as a source of funds for one-time items.
- The development of the FY 2002-03 Budget was based on expectations for demand for services and availability of funding to support those services. Two related factors pose significant negative risks to our expectations, the State of California’s budget crisis and the continuing weakness of the State’s economy.
- The U.S. and California economies continue to give mixed signals regarding solid growth. The San Diego economy continues to show positive growth but at a slower rate than the prior three years (e.g., gross regional product at 7.7 percent for 2000, at 2.2 percent for 2001, and at 1.8 percent for 2002). The County’s General Purpose Revenues (i.e., property tax, vehicle license fees, sales tax, real property transfer tax, transient occupancy tax and other minor revenues) continue to increase. Specifically:
 - Our two biggest sources of General Purpose Revenues are property taxes and vehicle license fees (VLF) representing 84 percent of the total. Neither property taxes nor vehicle license fees have been directly impacted by the downturn in the economy. Property taxes for fiscal year 2002-03 are budgeted to exceed fiscal year 2001-02 actuals by 7.3 percent and VLF revenue is budgeted to grow by 2 percent. Beginning in 1998, however, the State reduced the vehicle license fees paid by the

vehicle owners and backfilled the revenue loss to counties and cities from State general funds. The Governor, in order to remedy FY 2002-03 and FY 2003-04 State budget problems, is now proposing to eliminate the backfill to cities and counties beginning in February 2003. If approved by the legislature, the loss to San Diego County would be approximately \$60 million or 10 percent of our FY 2002-03 General Purpose revenues. For fiscal year 2003-04, the loss would be approximately \$125 million or 20 percent of our anticipated General Purpose Revenues. Impacts to County services are as yet uncertain.

- Sales tax, approximately 3 percent of General Purpose Revenues, has been more sensitive to the slowdown, and was budgeted at 9 percent below FY 2001-02 actuals but 5 percent above the FY 2001-02 budgeted level.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

- The real property transfer tax also makes up about 3 percent of the General Purpose Revenues. It is based on the dollar value of property sales and has been favorably impacted by the active real estate markets in the current environment of low interest rates. This revenue, too, was budgeted at 9.7 percent below FY 2001-02 actuals, but 2 percent above the FY 2001-02 budgeted level.
- The Governor of California has estimated a budget shortfall in fiscal year 2003 of \$10.2 billion (in the December 2002 proposal) and \$24.4 billion in the budget year (fiscal year 2003-04), for a total of \$34.6 billion. The Governor has proposed several measures to balance the State's budget, many of which, if approved by the legislature, will have significant consequences for County services both in fiscal year 2002-03 and fiscal year 2003-04. Any requirements for mid-year (FY 2002-03) service reductions will be brought to the Board of Supervisors for consideration and action.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to demonstrate the County's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Auditor and Controller's Office, County of San Diego, located at 1600 Pacific Highway, San Diego, California 92101.