



County of San Diego

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December 23, 2004

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

Ladies and Gentlemen:

We are 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, 2004 with the Independent Auditor's Report, submitted in compliance with California Government Code Section 25253. The Auditor and Controller's department 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. We believe that the data, as presented, is accurate in all material respects; that its presentation fairly shows the financial position and the changes in financial position 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.

The CAFR was prepared to satisfy the financial reporting requirements for state and local governments issued by the Governmental Accounting Standards Board (GASB), which require 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.

The CAFR has been audited by the independent certified public accounting firm of Macias Gini & Company LLP. The goal of the independent audit was to provide reasonable assurance about whether the basic financial statements of the County of San Diego for the fiscal year ended June 30, 2004, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall basic financial statement presentation. The independent certified public accounting firm concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County of San Diego's financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund and the aggregate remaining fund information, which collectively comprise the basic financial statements, as of and for the fiscal year ended June 30, 2004, present fairly, in all material respects, the financial position, changes in financial position and cash flows where applicable, thereof of the County of San Diego in conformity with accounting principles generally accepted in the United States of America.

The County is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and the U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Information related to this single audit, including the Schedule of Expenditures of Federal Awards, Findings and Questioned Costs, and the independent auditor's reports on internal control and compliance with applicable laws and regulations, are included in a separate annual publication.

Copies of this CAFR, and the Single Audit Report may be accessed on the Auditor and Controller's website at <http://www.sdcountry.ca.gov/auditor/> .

The 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 includes 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 Auditor's Report.

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.

SAN DIEGO COUNTY PROFILE

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 equable 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 2004 was estimated to be 3,017,200, an increase of 1.4% over January 2003, making it the third largest county by population in California. 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 1.294 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.

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 and the Auditor and Controller. 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 recent years the County has enjoyed economic stability, outpacing the state economy despite a downturn in California between 2001 and 2003. For example, the unemployment rate for the County has been lower than that of the State for the last 5 years, and at July 2004 was 4.4% as compared to 6.2% for the State. Much of this economic strength was characterized by employment gains, 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.

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. Highlights of County employment as of July 2004 are listed below.

- Non-agricultural employment totaled 1,257,000 jobs.
- The services industry constitutes the largest employment sector and accounted for approximately 44.4% of non-agricultural employment as of July 2004, with a total of 557,900 employed.
- The wholesale and retail trade industries were the second largest, non-government sector, comprising approximately 14.6% of non-agricultural employment with a total of 183,000 jobs.
- Government accounted for approximately 16.7% of total employment and manufacturing accounted for an additional 8.4%. While the U.S. Department of Defense contributed about \$13.6 billion to the local economy in 2002, through wages paid to the uniformed military and civilian personnel, and for equipment and services purchased from local businesses, preliminary estimates put the number above \$14.0 billion for 2003. San Diego's military presence is anticipated to remain relatively stable and may even increase due to the consolidation of military operations and facilities. Agriculture accounted for approximately .88% of total employment.
- 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. Construction also benefited in 2003 from the ongoing low interest rates.
- 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 2004 is expected to add approximately 30,100 jobs, up slightly from 2003.

County revenues such as property taxes, sales taxes, and charges for services that are dependent on the local economy 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 56% 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 supply and demand, real estate market activity is also affected by interest rates. Mortgage rates increased in 2004, but are expected to remain low by historical standards 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 in the unincorporated areas of the County. 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

The General Management System (GMS) is the formal comprehensive guide for planning, implementing, monitoring and rewarding all functions and processes of County Government. The GMS establishes good business practices and fiscal discipline, both of which are essential to achieve the County of San Diego's vision, "A County Government that has earned the respect and support of its residents." The purpose of the GMS is to optimize the efficient application of resources in the delivery of services to our residents. 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: County government will be able to provide superior services if it sets sound goals and applies strong management principles to achieve those goals.

The County has an annual budget of more than \$4 billion and almost seventeen thousand 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. The GMS then links goal setting and 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 process. This is followed by the short-term, two-year operational planning process, which encompasses the budget process and wherein each department's strategic objectives and resources allocated to achieving them are detailed. Monitoring and control take 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 encourage 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, the success of the GMS 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

In Fiscal Year 2003-04 three significant external events overlaid the allocation and availability of County financial, human, and physical resources in support of strategic efforts.

- In late October 2003, four simultaneous wildfires, know collectively as "Firestorm 2003", burned almost 400,000 acres in San Diego County, causing loss of life and extensive damage to both public and private property. The estimated structural damage loss in the unincorporated area only is \$862 million. County government initiated short-term and long-term responses including emergency communications and public safety responses, spearheading the efforts at regional fire protection and communications systems upgrades, coordinating Federal Emergency Management Agency funding and other grants, and rebuilding County property. In some cases, federal and State funding sources are expected to reimburse County funding for cleanup, support, and prevention of future catastrophic disasters. In others, however, County resources were and will be expended in order to restore balance and safety to the physical environments of San Diego County.
- Second, the failure of State government to develop a viable long-term solution to its budget imbalance remains a risk to funding and stability of County programs, since State aid is the primary source of County revenues. Although, according to the California Legislative Analyst's Office ("LAO") the California economy has improved, the budget still relies on one-time spending such as debt issuance and has a structural operating shortfall. Risk and uncertainty surrounding State support to local governments for mandated as well as discretionary programs persisted throughout Fiscal Year 2003-04 and is expected to remain.
- Finally, the September 11, 2001, terrorist attacks and ensuing domestic and international Wars on Terrorism continue to color all public safety efforts of local government. San Diego County, with a concentration of direct and indirect military spending, is impacted at several levels of government and the economy.

In spite of the events in the external environment, County government continues to follow the map of the five-year long-term Strategic Plan developed within the discipline of the GMS. The County's Strategic Plan defines broad organization-wide goals as Strategic Initiatives, which help prioritize specific 'front-line' County efforts and programs. The Strategic Initiatives are:

KIDS

Improve opportunities for children

THE ENVIRONMENT

Promote natural resource management strategies that ensure environmental preservation, quality of life, and economic development.

SAFE AND LIVABLE COMMUNITIES

Promote safe and livable communities

The Strategic Plan also recognizes that maintaining operational excellence is what enables us to accomplish our Strategic Initiative goals. Key Required Disciplines of operations include:

- Fiscal Stability
- Customer Satisfaction
- Regional Leadership
- Skilled, Competent Workforce
- Essential Infrastructure
- Information Management
- Accountability/Transparency
- Continuous Improvement

Within the structure of the two-year operational planning process, the County plans for and attains interim progress toward achievement of the Strategic Initiatives. Some of the significant steps of the last year were:

KIDS

- Fully immunized 88% of children served by public health centers, exceeding both State (76%) and national (73%) rates
- Exceeded Federal performance measure standards for child support services
- Increased access to Megan's Law database
- Opened a new teen center in Lakeside and new playgrounds and ball fields in County Parks
- Recruited student poll workers and provided polling booths and mock voting materials to schools
- Enhanced emergency preparedness via the Terrorism Public Education Campaign
- Reached out to communities in diverse County programs and services for families, such as prevention of domestic violence and animal cruelty, food safety and nutrition, and West Nile Virus education
- Collaborated with other agencies in a Countywide Literacy Initiative and other joint programming to promote reading

THE ENVIRONMENT

- Maintained compliance with the Federal one-hour ozone standard
- Continued cleaning programs for culverts, drainage channels, and roads to keep debris out of rivers, bays, and the ocean
- Protected groundwater resources by monitoring underground storage tanks and enforcing actions against violations
- Acquired 1,546 acres of open space in the Multiple Species Conservation Program and other open space areas
- Completed the installation of energy-saving devices and demand-management projects in County facilities
- Trained County employees in Stormwater Pollution Prevention for the workplace

SAFE AND LIVABLE COMMUNITIES

- Responded to the catastrophic events of Firestorm 2003
 - Provided Emergency Medical Services and activated Emergency Operations Center for county-wide efforts and coordination with State agencies
 - Implemented a number of aids to fire victims, including health services, crisis counseling, child care, information hotlines, one-stop assistance centers, anti-fraud efforts, and assessment of agricultural loss
 - Marshaled County employees for Safety and Damage Assessment Teams
 - Initiated post-fire erosion control and debris removal programs
 - Mended and replaced damaged and destroyed County property, such as roads and parks facilities
- Completed \$21 million in capital improvement projects for parks facilities, part of a five-year capital improvement plan
- Completed facilities and other upgrades in support of the new Voting System
- Prosecuted consumer fraud lawsuits with other agencies concerning price scanner overcharging and inaccurate product packaging
- Conducted a major campaign in all County facilities for improvements in workplace safety and injuries
- Enhanced communities through a variety of library services: a new library in Spring Valley, renovations in Del Mar, Imperial Beach, and El Cajon branches to comply with the Americans with Disabilities Act, and expanded access to and filters on all Library computers with public Internet availability

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

As noted above, a five-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. During the year departments may request budget adjustments for new and existing programs. In addition, the Chief Administrative Officer reviews the status of the County's performance against budget in a quarterly status report to the Board of Supervisors.

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 the adoption of enhanced retirement benefits in March 2002, the County incurred an increased obligation pursuant to the Retirement Law as an unfunded accrued actuarial liability (UAAL) to the Association. In June 2004, the County issued \$454.1 million in Pension Obligation Bonds (POBs), the proceeds of which were primarily used to fund the aforementioned UAAL. As of June 30, 2004, the total estimated UAAL was \$1,202.7 million. For further details concerning this transaction, please refer to Note 5(I) to the Financial Statements. The retirement plan's funding status (the ratio of system assets to system liabilities) at June 30, 2004 was 81.1%.

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 (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, 2004, the average yield on investments was 1.59%.

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 the Risk Management Internal Service Fund (ISF) with the exception of insurance purchased by the County in excess of \$1 million for workers compensation that is recorded in the County's General Fund. The ISF accounts for all uninsured employee risk management activities and for all uninsured public risk management activities, such as premises liability, medical malpractice, false arrest, and general liability. Risk liability levels are determined by actuarial studies, and reserves are being funded over a multi-year period from the rate structures charged to the operating funds. This ISF is also discussed in Note 5B to the Financial Statements.

INDEPENDENT AUDIT

County Charter Section 802 requires an annual audit of the County's accounts and financial transactions. As previously discussed, the certified public accounting firm, Macias Gini & Company LLP, has audited the accompanying basic financial statements compiled from these records. Their Independent Auditor's 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, 2003. 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

Even with the financial and environmental challenges of Fiscal Year 2003-04, the County was recognized for many activities that highlight progress in the Strategic Plan Initiatives. County programs received awards for operational and service delivery achievements, technological innovations, and prudent fiscal management.

- In early 2004, 29 County of San Diego programs were selected for Achievement Awards by the National Association of Counties (NACo). The NACo awards extend to efforts in all three of the strategic initiatives. Of the 106 U.S. counties receiving recognition, San Diego County received the second highest number of awards given to any county for such accomplishments as the Emancipated Foster Youth Transitional Housing Program, "Fight the Bite" response plan to the West Nile Virus, and a variety of Firestorm 2003 responses to both the human and the environmental elements of that disaster.
- The County of San Diego was one of only ten California Counties to receive a Challenge Award from the California State Association of Counties (CSAC) in 2004 for the Risk Mitigation and Litigation Program.
- The County of San Diego ranked #1 on a list of the nation's most digital-savvy counties, according to the 2004 Digital Counties Survey, which examined how county governments use information technology to deliver services to citizens. The nationwide survey was conducted jointly by the Center for Digital Government, NACo, and Government Technology magazine.
- County Television Network (CTN), the local government access channel for the County of San Diego, was awarded four Emmy awards by the National Association of Television Arts and Sciences/Pacific Southwest Chapter, for programming excellence and was received first place for Overall Excellence in 2004 by the Southern California and Nevada/National Association of Telecommunications Officers Association.
- The GFOA also awarded its Distinguished Budget Presentation Award to the County for Fiscal Year 2003-04 Operational Plan.
- The San Diego County Taxpayers' Association (SDCTA) awarded their 2004 Regional Golden Watchdog Award to the San Diego County District Attorney for the DA's Elder Abuse Program, with

the County's Public Purchasing: Changing Times, Changing Ways program named a finalist in the same category

ACKNOWLEDGMENTS

We would like to express our appreciation to the accounting staffs of County departments and the staff of the Auditor and Controller's department whose coordination, dedication and professionalism are responsible for the preparation of this report. We would also like to thank Macias Gini & Company LLP for their professional support in the preparation of the CAFR. Lastly, we 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,



DONALD F. STEUER
Chief Financial Officer



TRACY M. SANDOVAL
Auditor and Controller