

MANAGEMENT’S DISCUSSION AND ANALYSIS (MD&A)

This section of the County’s annual financial report provides a narrative overview and analysis of the financial activities of the County for the year ended June 30, 2005. 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. Unless otherwise indicated, all amounts in this section are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

- Total net assets increased by \$286,953, or 8% as compared to last year.
- Long-term debt decreased by \$70,100, or 5% during the current fiscal year.
- As of the end of the fiscal year, the County’s governmental funds reported combined ending fund balances of \$1,948,943, an increase of \$108,837, or 6% in comparison with the prior year.
- At June 30, 2005, unreserved fund balance in the General Fund was \$163,548, or 7% of total FY 2004-05 expenditures and transfers of \$2,424,356.
- General Fund revenues and transfers ended the year 1% above budget.
- General Fund expenditures and transfers ended the year 8% below budget.

OVERVIEW OF THE FINANCIAL STATEMENTS

The basic financial statements presented in the County’s CAFR have been divided into three different sections:

- Government-wide Financial Statements
- Fund Financial Statements
- Notes to the Basic Financial Statements

<i>Basic Financial Statements</i>			
Government-wide Financial Statements	Fund Financial Statements		
	Governmental Funds	Proprietary Funds	Fiduciary Funds
Statement of Net Assets	Balance Sheet	Statement of Net Assets	Statement of Fiduciary Net Assets
Statement of Activities	Statement of Revenues, Expenditures, and Changes in Fund Balances	Statement of Revenues, Expenses, and Changes in Fund Net Assets	Statement of Changes in Fiduciary Net Assets
Statement of Activities	Budgetary Comparison Statement	Statement of Cash Flows	Statement of Changes in Fiduciary Net Assets
Notes to the Basic Financial Statements			

The following table summarizes the major features of the basic financial statements:

	Government-wide Financial Statements	Fund Financial Statements		
		Governmental Funds	Proprietary Funds	Fiduciary Funds
Type of Financial Statement	Statement of Net Assets and Statement of Activities	Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances	Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Fund Net Assets, and Statement of Cash Flows	Statement of Fiduciary Net Assets and Statement of Changes in Fiduciary Net Assets
Scope	Entire entity (except fiduciary funds)	Day-to-day operating activities for basic services	Day-to-day operating activities for business-type services	Resources on behalf of others
Accounting basis and measurement focus	Accrual accounting and economic resources measurement focus	Modified accrual and current financial resources measurement focus	Accrual accounting and economic resources measurement focus	Accrual accounting & economic resources focus; except agency funds do not have measurement focus
Type of asset and liability information	All assets and liabilities, both financial and capital, short-term and long-term	Current assets and liabilities that come due during the year or soon thereafter	All assets and liabilities, both financial and capital, short-term and long-term	All assets held in a trustee or agency capacity for others
Type of inflow and outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during the year or soon thereafter; expenditures when goods or services have been received and the related liability is due and payable	All revenues and expenses during the year, regardless of when cash is received or paid	All additions and deductions during the year, regardless of when cash is received or paid

Government-wide Financial Statements

The government-wide financial statements consist of the following two financial statements: the Statement of Net Assets and the Statement of Activities. Both of these statements were prepared using an accounting method and a measurement focus similar to those used by private-sector companies, the accrual basis of accounting and the economic resources measurement focus. The **Statement of Net Assets** provides information regarding all of the County's 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**, on the other hand, provides information on how the government's net assets changed during the most recent fiscal year regardless of the period when the related cash or cash equivalent is received or paid. Therefore, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (for example, uncollected taxes and earned but unused vacation leave).

The Statement of Net Assets and the Statement of Activities distinguish functions of the County that are principally supported by taxes (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 (1) general government, (2) public protection, (3) public ways and facilities, (4) health and sanitation, (5) public assistance, (6) education, and (7) recreation and cultural services. The business-type activities of the County include airport and waste management.

The government-wide financial statements also provide information regarding the County's component units, entities for which the County (the primary government) is considered to be financially accountable. Blended component units, although legally separate entities, are in substance, part of the County's operations, and therefore, data from these component units are combined with data of the primary government. Financial information for the Children and Families Commission of Orange County, a discretely presented component unit, is reported separately from the financial information presented for the primary government itself.

Fund Financial Statements

- **Fund** – a separate accounting entity with a self-balancing set of accounts.
- Focus is on major funds.
- Provides information regarding the three major categories of all County funds: **governmental, proprietary, and fiduciary**.

The fund financial statements report on groupings of related funds that are used to maintain control over resources that have been segregated for specific activities or objectives. A fund is a separate accounting entity with a self-balancing set of accounts. Like other state and local governments, the County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of governmental and proprietary fund financial statements is on major funds as determined by the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 34 "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*." All of the County funds can be divided into three major categories of funds: governmental, proprietary, and fiduciary.

Governmental funds - Governmental funds include most of the County's basic services and 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 are prepared using the modified accrual basis of accounting and current financial resources measurement focus.

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. Reconciliations are prepared for both the governmental funds' Balance Sheet and the governmental funds' Statement of Revenues, Expenditures, and Changes in Fund Balances to facilitate comparisons between governmental funds and governmental activities. The primary differences between the government-wide and fund financial statements relate to noncurrent assets, such as land and structures and improvements, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund financial statements.

In FY 2004-05, an increase of \$233,859 in net assets in the government-wide financial statements was reported, while an increase of \$108,837 in fund balance was reported in the fund financial statements. Refer to the "Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities" for details on the factors contributing to this difference.

The County maintains several individual governmental funds organized according to their type (General Fund, Special Revenue, Debt Service, Capital Projects and Permanent Funds). Information is presented separately in the governmental funds Balance Sheet and in the Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund, which is always a major fund, and all other major funds. Information for nonmajor funds is presented in the aggregate in these statements. Individual fund data for each of the nonmajor governmental funds is presented elsewhere in this report. The County adopts an annual appropriated budget for its governmental funds. Budgetary comparison statements and schedules have been provided for these funds to demonstrate compliance with the budget.

Proprietary funds - The County maintains two different types of proprietary funds: Enterprise Funds and Internal Service Funds. **Enterprise Funds** are used to report the same functions presented as business-type activities in the government-wide financial statements. The County uses enterprise funds to account for its Airport and Waste Management operations (IWMD). **Internal Service Funds** are used to accumulate and allocate costs internally among the County's various functions such as insurance services, transportation, publishing, and information technology. 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 fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Airport and Waste Management operations, which are both considered to be major funds of the County. Conversely, the Internal Service Funds are combined into a single, aggregated presentation in the proprietary funds financial statements with the individual fund data provided in combining statements, which can be found elsewhere in this report.

Fiduciary funds - Fiduciary funds include the **Trust** and **Agency** funds and are used to account for assets held on behalf of outside parties, including other governments. Financial information for fiduciary funds is not reported in the government-wide financial statements because the resources of these funds are not available to support the County's programs. The combining statements for fiduciary funds are included elsewhere in this report.

Notes to the Basic Financial Statements

The 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. To find a specific note, refer to the Table of Contents.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of the County's financial position. At June 30, 2005, the County's combined net assets (governmental and business-type activities) totaled \$3,888,301, an increase of 8% from FY 2003-04.

The largest component of the County's net assets (69%) was **invested in capital assets, less any related outstanding debt** used to acquire those assets. Capital assets include land, structures and improvements, equipment, construction in progress, and infrastructure that are used to provide needed services to the citizens of the County. Since the capital assets themselves cannot be used to liquidate the associated debt, the resources needed to repay the debt must be provided from other sources.

COMPONENTS OF NET ASSETS

- Invested in Capital Assets, Net of Related Debt
- Restricted
- Unrestricted

The County's **restricted** net assets are \$1,260,554 (32%) of its net assets. This means that these resources 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.

The final component of net assets is **unrestricted net assets**. Unrestricted net assets are resources that the County may use to meet its ongoing obligations to citizens and creditors. As of June 30, 2005, governmental activities showed a negative amount of \$44,929 in unrestricted net assets. The deficit balance shown for unrestricted net assets was caused primarily by the County's election to settle bankruptcy-related debt according to the Modified Second Amended Plan of Adjustment, and is not a reflection of the County's lack of resources to meet its ongoing obligation to the citizens and creditors. Please refer to Note 9, Long-Term Obligations, and Note 19, Subsequent Events, for more details of this Plan.

The following table presents condensed financial information derived from the government-wide Statement of Net Assets:

NET ASSETS – Primary Government
 June 30, 2005

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
ASSETS						
Current and other assets	\$ 2,875,262	\$ 2,635,324	\$ 596,702	\$ 555,986	\$ 3,471,964	\$ 3,191,310
Capital assets	2,410,746	2,320,885	507,408	499,987	2,918,154	2,820,872
Total Assets	5,286,008	4,956,209	1,104,110	1,055,973	6,390,118	6,012,182
LIABILITIES						
Long-term liabilities	1,649,663	1,650,412	356,045	363,678	2,005,708	2,014,090
Other liabilities	431,240	334,551	64,869	62,193	496,109	396,744
Total Liabilities	2,080,903	1,984,963	420,914	425,871	2,501,817	2,410,834
NET ASSETS						
Invested in capital assets, net of related debt	2,336,881	2,259,064	335,795	315,335	2,672,676	2,574,399
Restricted	913,153	992,774	347,401	314,767	1,260,554	1,307,541
Unrestricted	(44,929)	(280,592)	--	--	(44,929)	(280,592)
Total Net Assets	\$ 3,205,105	\$ 2,971,246	\$ 683,196	\$ 630,102	\$ 3,888,301	\$ 3,601,348

As of June 30, 2005, the County's total assets increased by 6%, or \$377,936 during the current fiscal year. Of this amount, current and other assets increased by \$280,654 (9%), while capital assets increased by \$97,282 (3%). Total liabilities for this year increased by 4% or \$90,983. Of this amount, long-term liabilities decreased by \$8,382 (0.4%), while other liabilities increased by \$99,365 (25%) which primarily consisted of deposits from others of \$70,074.

The following table provides summarized data of the government-wide Statement of Activities:

CHANGES IN NET ASSETS – Primary Government
For the Year Ended June 30, 2005

	Governmental		Business-Type		Total	
	Activities		Activities			
	2005	2004	2005	2004	2005	2004
REVENUES						
Program Revenues:						
Charges for Services	\$ 470,259	\$ 436,139	\$ 210,103	\$ 203,155	\$ 680,362	\$ 639,294
Operating Grants and Contributions	1,540,938	1,532,106	13,968	7,459	1,554,906	1,539,565
Capital Grants and Contributions	66,889	55,337	10,703	6,183	77,592	61,520
General Revenues:						
Property Taxes	387,204	342,412	--	--	387,204	342,412
Property Taxes in Lieu of Motor Vehicle License Fees	141,319	--	--	--	141,319	--
Other Taxes	48,862	51,104	--	--	48,862	51,104
Grants and Contributions not Restricted to Specific Programs	9,442	11,969	--	--	9,442	11,969
State Allocation of Vehicle Motor License Fees	54,325	189,732	--	--	54,325	189,732
Other General Revenues	79,497	69,776	314	965	79,811	70,741
Total Revenues	2,798,735	2,688,575	235,088	217,762	3,033,823	2,906,337
EXPENSES						
General Government	171,771	170,820	--	--	171,771	170,820
Public Protection	947,698	905,229	--	--	947,698	905,229
Public Ways and Facilities	77,928	78,454	--	--	77,928	78,454
Health and Sanitation	455,059	447,743	--	--	455,059	447,743
Public Assistance	740,987	731,698	--	--	740,987	731,698
Education	30,641	31,978	--	--	30,641	31,978
Recreation and Cultural Services	73,530	76,249	--	--	73,530	76,249
Interest on Long-Term Debt	81,841	78,474	--	--	81,841	78,474
Airport	--	--	79,882	78,235	79,882	78,235
Waste Management	--	--	87,533	70,858	87,533	70,858
Total Expenses	2,579,455	2,520,645	167,415	149,093	2,746,870	2,669,738
Excess (Deficit) before Transfers	219,280	167,930	67,673	68,669	286,953	236,599
Transfers	14,579	12,155	(14,579)	(12,155)	--	--
Increase in Net Assets	233,859	180,085	53,094	56,514	286,953	236,599
Net Assets - Beginning of the Year	2,971,246	2,791,161	630,102	573,588	3,601,348	3,364,749
Net Assets - End of the Year	\$ 3,205,105	\$ 2,971,246	\$ 683,196	\$ 630,102	\$ 3,888,301	\$ 3,601,348

As of June 30, 2005, the County's net assets increased by 8%, or \$286,953 during the current fiscal year. Revenues for the year totaled \$3,033,823, an increase of \$127,486 from the previous year and expenses totaled \$2,746,870, an increase of \$77,132.

Governmental Activities

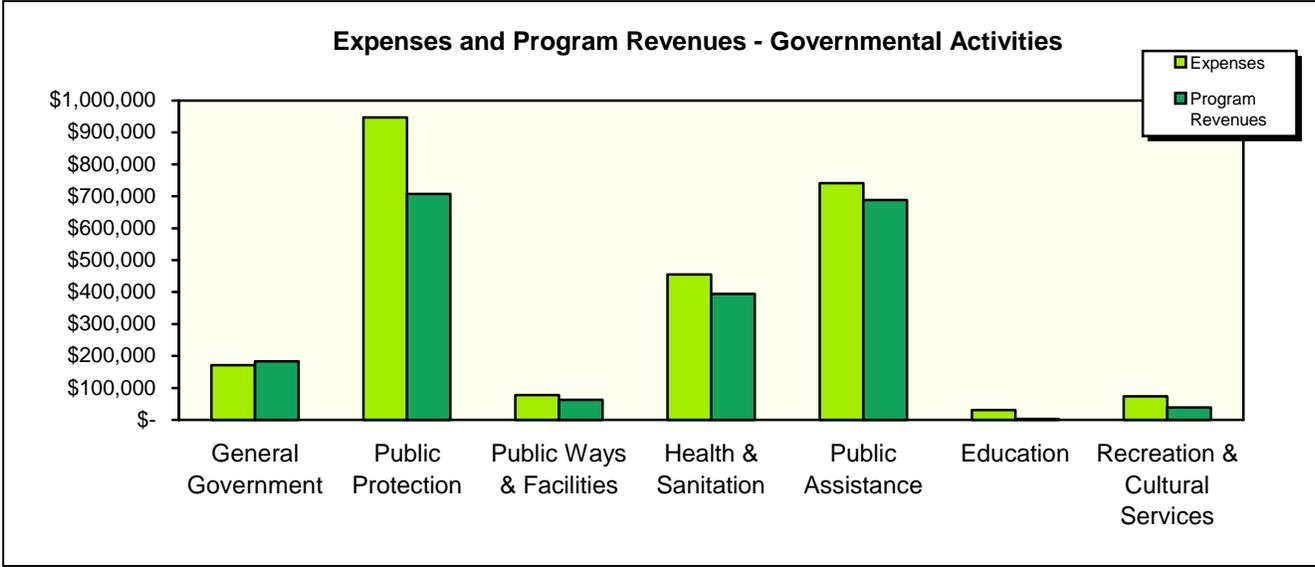
The County's governmental activities rely on several sources of revenue to finance ongoing operations. Operating Grants and Contributions comprised the largest revenue source for the County followed by Charges for Services. Operating Grants and Contributions are monies received from parties outside the County and are generally restricted to one or more specific programs such as the State and Federal revenues for public assistance and for health care. In the governmental funds, expenditure-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other grant requirements have been met. As expenditures increase, revenues increase proportionately. 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 engineering services provided to cities under contract, park and recreation fees, and law enforcement services provided to governmental agencies under contract.

At the end of FY 2004-05 total revenues for the governmental activities, including transfers from the business-type activities were \$2,813,314, an increase of \$112,584 from the previous year. Expenses totaled \$2,579,455, an increase of \$58,810 from the prior year. The majority of these expense increases were in the Public Protection and Public Assistance functions. While revenues and expenses increased from the prior year, revenues still exceeded the expenses. Governmental activities increased the County's net assets by \$233,859, accounting for 81% of the total growth in the net assets of the County. In addition to the effects of expenditure-driven grants, key elements of the increase are as follows:

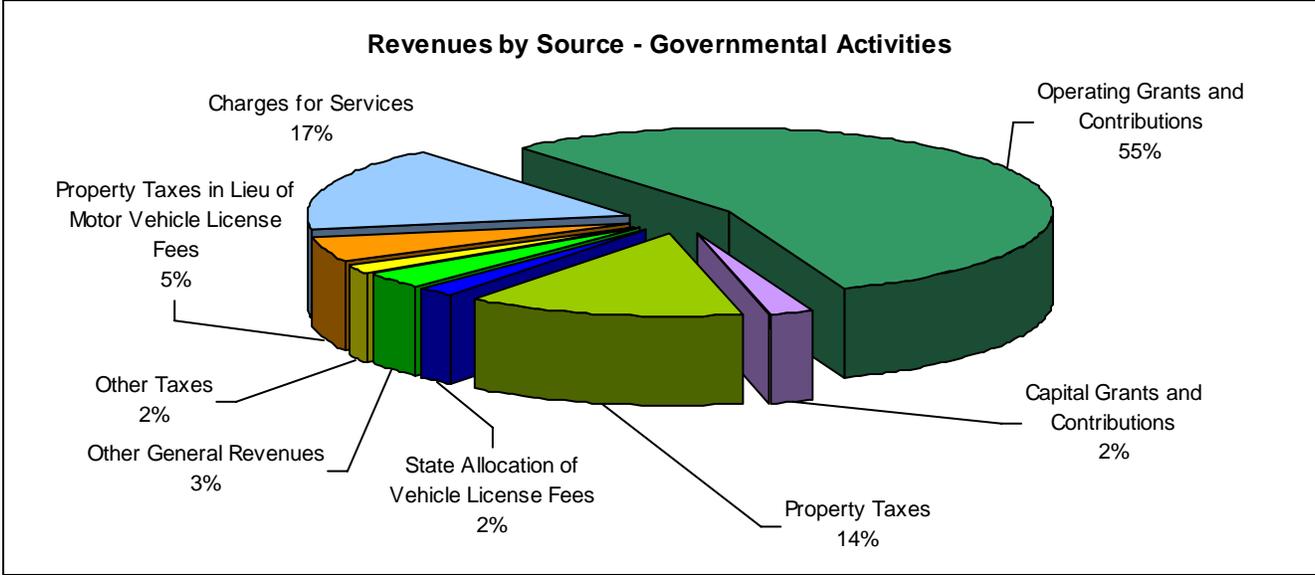
- Property taxes increased by \$44,792 due to a large number of home sales and remodels as a result of the continued low housing interest rates.
- The State Allocation of Motor Vehicle License Fees (VLF) decreased by \$135,407, while Property Tax in Lieu of VLF revenue increased by \$141,319. These variances were a result of the FY 2004-05 State Budget Act that "swapped" Property Tax in Lieu of VLF. The budget legislation permanently lowered the VLF rate from 2% to 0.65% of the assessed value of the vehicle. Prior to this legislation, the State "backfilled" 1.35% of the 2% VLF to the counties. In FY 2004-05, the Property Tax in Lieu of VLF revenue also included a \$17,670 increase due to increased VLF receipts. See Note 1.L, Summary of Significant Accounting Policies for more information.
- Capital Grants and Contributions increased by \$11,552 due mainly to proceeds from the issuance of long-term debt for the Community Facilities District (CFD) 2004-1 Ladera Construction bond.
- Charges for Services increased by \$34,120 primarily due to (1) a \$4,107 increase in assessment and tax collection revenues due to record sales prices and market activity during the year, (2) a \$4,269 increase in election services due to a higher number of participating jurisdictions, (3) a \$14,338 increase due to revenue recognized for the Clerk Recorder automation enhancement, (4) a \$8,934 increase in environmental health fees due to a change in billing from annual to anniversary billings and (5) a \$3,593 increase in mental health services, which was offset by corresponding expenditures.

In addition to the above, the County received \$1,375 of deferred pass-through tax incremental revenue from the City of Yorba Linda Redevelopment Agency. This is the second of three annual installment payments agreed to by the Yorba Linda Redevelopment Agency.

The following chart presents a comparison of expenses by function and the associated program revenues for governmental activities:

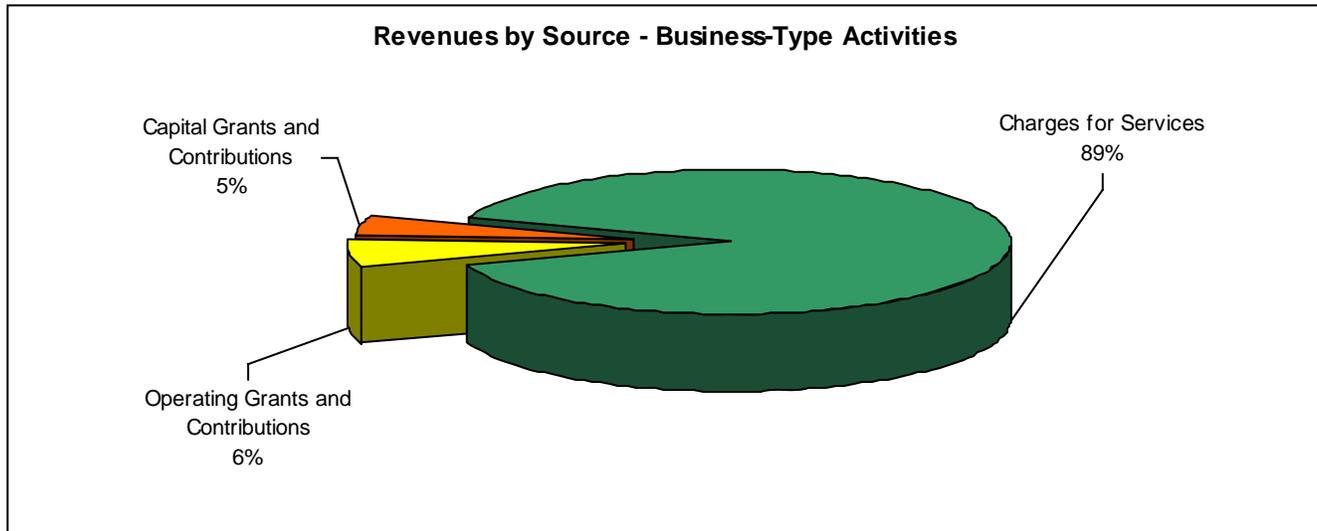


The chart below presents the percentage of total revenues by source for governmental activities:



Business-Type Activities

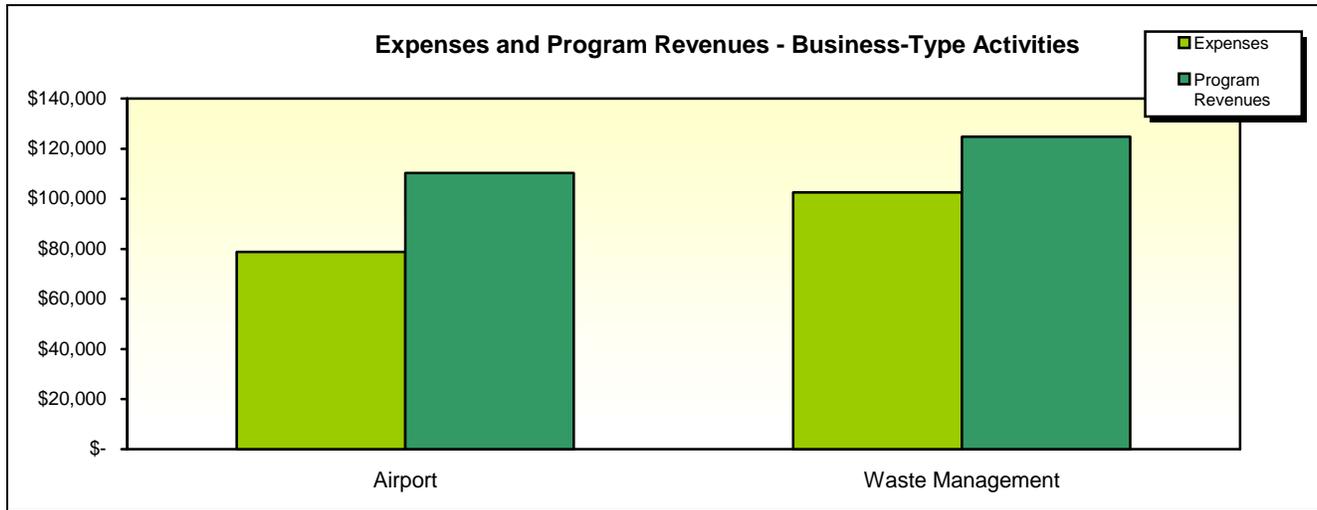
The County has two business-type activities: Airport and Waste Management. In keeping with the intent of recovering all or a significant portion of their cost through user fees and charges, business-type activities reported Charges for Services as their largest source of revenues. Operating Grants and Contributions, as well as Capital Grants and Contributions, were the other revenue sources for Airport and Waste Management activities. Capital Grants and Contributions include revenues received from the Federal Aviation Administration for use in airport construction projects.



At the end of FY 2004-05, business-type activities reported total revenues of \$235,088, an increase of \$17,326 from the prior year. Expenses, including transfers to the governmental activities, totaled \$181,994, resulting in an increase of \$20,746 from the previous year. The program revenues (Charges for Services, Operating Grants and Contributions, and Capital Grants and Contributions) financed the majority of expenses recorded for the business-type activities. Other factors concerning the finances of the County's two enterprise funds are discussed in the Proprietary Funds section of the "Financial Analysis of the County's Funds." At the end of FY 2004-05, there was an increase of \$53,094 in net assets as compared to an increase of \$56,514 in FY 2003-04. The increase in net assets was mostly due to increased revenues, however, there was also a large increase in expenses. Key elements for the increase are as follows:

- A \$ 10,194 increase in landfill Postclosure liabilities and Postclosure settlement costs.
- A \$4,875 increase in rents and concession from airline rent, parking, and car rental due to the increased number of passengers and the level of traveler activities at the airport.
- A \$4,519 increase in grant revenues for the construction of new passenger security lanes, acquisition of a new aircraft rescue firefighting vehicle, remodeling of the fire station #33 facility, rehabilitation of taxiway "E", reconstruction of Perimeter Road West, and security modifications at the terminal.
- A \$1,675 increase in refuse disposal fees due to an increase in the amount of "in-county" tonnage disposed at the landfills.

The following chart shows expenses by function and the associated program revenues for the business-type activities:



FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

The County uses fund accounting to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

Governmental Funds

Governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Such information may be useful in evaluating the County's near-term financing requirements.

In particular, unreserved fund balance may serve as a valuable measure of the government's resources that are available for spending at the end of the fiscal year. This amount is available for spending at the discretion of the County's Board of Supervisors in order to achieve the established function of the respective funds. Other than the General Fund, all other County funds are restricted for the particular purpose that each fund was established for. For example, special revenue funds have either legal or operational requirements to restrict expenditures for specified purposes, and debt service funds are restricted for payment of principal and interest on general long-term debt. Commitments by the County related to executory contracts for goods or services are recorded and established as reservations of fund balances in the governmental funds.

At June 30, 2005, the County's governmental funds reported total fund balances of \$1,948,943 with an increase of \$108,837 in comparison with the prior year. Of the total fund balances for the governmental funds, \$830,631 (43%) constitutes *unreserved fund balances*.

A significant amount of these unreserved fund balances are designated by the Board of Supervisors for the following uses in the next fiscal year and are deemed to be restrictions, commitments, or limitations, which affect the availability of fund resources in the next fiscal year:

<u>Funds</u>	<u>Planned Uses of Unreserved Fund Balances</u>
General Fund	- Deferred maintenance projects at various County facilities, Americans with Disabilities Act (ADA) improvement projects, re-budgeted capital projects, and projects at the County Central Utility Facility, which include refurbishment of the steam and chilled water system and the co-generation project.
Roads	- Construction and maintenance of roadways, and for specialized engineering services to other governmental units and the public.
Public Library	- Library services for the unincorporated areas as well as some of the incorporated areas within the County.
Tobacco Settlement	- Specified health care services and for public safety.
Refunding Bonds and Recovery Certificates of Participation (COPs) and Debt Prepayment	- Defeasance of the non-callable portions of the bankruptcy debt and refunding the remaining principal.
Flood Control District	- Planning, construction, operation, and maintenance of regional flood protection and water conservation works, such as dams, control channels, retarding basins and other flood control infrastructure.
Harbors, Beaches and Parks	- Development and maintenance of County harbors, tidelands and related aquatic recreational facilities, as well as the acquisition, operation and maintenance of County beaches, inland regional park recreation facilities and community park sites in the unincorporated areas.
Other Governmental	- Various capital projects in Ladera Ranch.

The remaining fund balances are *reserved*. Reserved fund balances primarily represent assets that are not available for spending or assets that are not yet available for expenditure due to restrictions imposed by parties outside the County. Note 12 of this report provides a complete list of the reserved fund balances which are titled "Assets Not Available for Appropriations," as well as Board reserves which are titled "Fund Balances Reserved by Board of Supervisors for a Future Purpose."

Comparative Analysis of Changes in Fund Balances

The following schedule presents a summary of revenues and other financing sources, expenditures and other financing uses, and the net changes in fund balances for the governmental funds for the current and previous fiscal years:

**GOVERNMENTAL FUNDS
COMPARATIVE SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
For the Year Ended June 30, 2005**

	Revenues and Other Financing Sources		Expenditures and Other Financing Uses		Net Change in Fund Balances	
	2005	2004	2005	2004	2005	2004
General Fund	\$ 2,442,533	\$ 2,291,343	\$ 2,424,356	\$ 2,308,807	\$ 18,177	\$ (17,464)
Roads	38,765	47,973	43,881	39,856	(5,116)	8,117
Public Library	32,433	29,156	30,972	32,471	1,461	(3,315)
Tobacco Settlement	31,031	31,375	32,179	41,858	(1,148)	(10,483)
Refunding Bonds and Recovery COPs & Debt Prepayment	119,543	102,998	100,445	98,045	19,098	4,953
Flood Control District	72,629	72,870	125,086	75,936	(52,457)	(3,066)
Harbors, Beaches, and Parks	81,359	71,207	72,429	71,218	8,930	(11)
Other Governmental	443,531	476,960	323,639	429,867	119,892	47,093
Total	\$ 3,261,824	\$ 3,123,882	\$ 3,152,987	\$ 3,098,058	\$ 108,837	\$ 25,824

In addition to the effects of expenditure-driven grants, the following information provides explanations for the significant changes in fund balance:

General Fund

The General Fund is the chief operating fund of the County. At the end of FY 2004-05, there was an increase in fund balance of \$18,177. Property tax revenues increased by \$4,700 as a result of the continued strength in the real estate market. Transfers from various Special Revenue Funds to the General Fund decreased by \$53,028.

While revenues for the General Fund increased, pension costs also increased. At the end of FY 2004-05, retirement costs increased by \$66,983. For further information, refer to Note 17, Retirement Plans. Capital expenditures increased by \$33,330. The increase was primarily attributable to a capital lease the County entered into for Social Services Agency for the Santa Ana Regional Center.

Roads

This fund accounts for the maintenance and construction of roadways, and for specialized engineering services to other governmental units and the public. At the end of FY 2004-05, there was a decrease in fund balance of \$5,116. In comparison to last year, revenues from Charges for Services decreased by \$8,884. Last year, there was over \$8,000 in revenue from the Ladera CFD for the Antonio Parkway. Expenditures increased by \$5,017 because capital projects and related professional services that were delayed last year were expended this year.

Public Library

This fund accounts for library services for the unincorporated areas as well as some of the incorporated areas within the County. There was a \$1,461 increase to fund balance this fiscal year. The Public Library Fund had an increase of \$2,254 in property tax revenues from rising home prices and new housing construction in the areas for which it receives property tax revenue. In comparison to the prior year, expenditures decreased by \$1,499. Last year, expenditures were higher due to a one-time payment of property taxes to the City of Newport Beach for former unincorporated areas that were annexed and a one-time payment to the Capistrano School District for the library's share of the Ladera Ranch branch library.

Tobacco Settlement

This fund accounts for tobacco settlement monies allocated to the County from the State of California, pursuant to the Master Settlement Agreement between the major tobacco companies and 46 states (including California), the District of Columbia and four U.S. Territories. At the end of FY 2004-05, fund balance continued to decline by \$1,148, primarily due to a decrease in loan repayment for the Theo Lacy Jail capital project from the previous year. Also reducing fund balance was an \$817 reduction in revenues for a refund of an unused deposit from the service provider for the 64-bed Theo Lacy in-custody program.

Refunding Recovery Bonds and Recovery Certificates of Participation and Debt Prepayment

This fund accounts for the debt service transactions handled by the trustee bank for the 1995 Refunding Recovery Bonds and the 1996 Recovery Certificates of Participation. This fund also accounts for early debt reduction of the County's outstanding bonds. At the end of FY 2004-05, there was an increase in fund balance of \$19,098. The increase is due primarily to an \$18,300 transfer from the General Fund. For more information, refer to Note 19, Subsequent Events. An allocation of \$1,375 from the Yorba Linda Redevelopment Settlement also contributed to the increase in fund balance.

Flood Control District

This fund accounts for the planning, construction and operation of flood control and water conservation works, such as dams, basins, and trunk channels, and for the retardation, conservation and controlled discharge of storm waters. At the end of FY 2004-05, there was a decrease in fund balance of \$52,457. While revenues remained constant from this year to last year, expenditures increased significantly. The following is a brief summary of the primary reasons for the net decrease in fund balance for the Flood Control District in FY 2004-05 as compared to the prior year:

- A \$58,518 increase in expenditures for the acquisition of property rights for the Santa Ana River Mainstream/Prado Dam Project for the expansion of the reservoir area.
- A \$9,463 decrease in expenditures for the Santa Ana River Mainstream project.

Harbors, Beaches and Parks

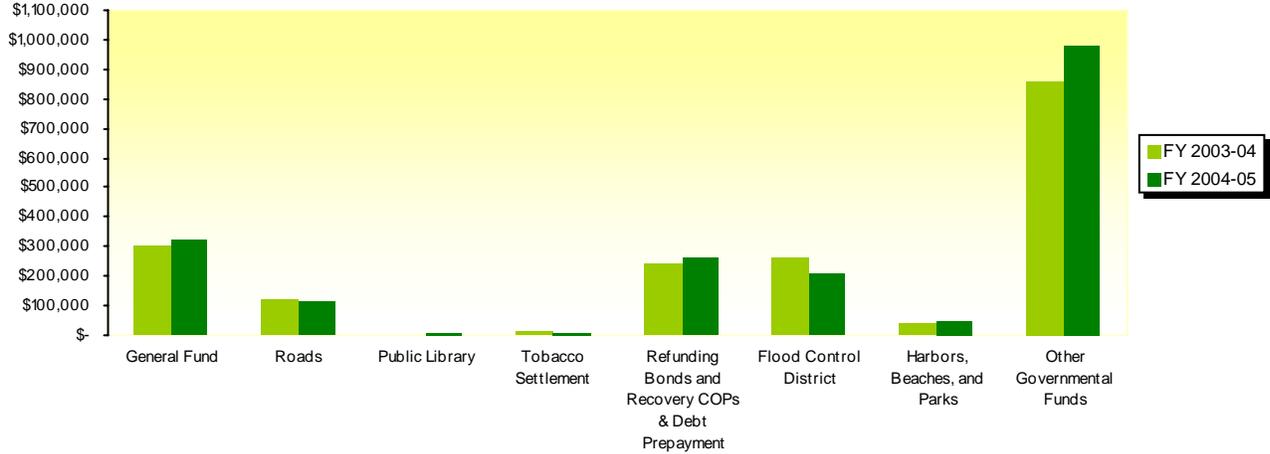
This fund accounts for the development of aquatic recreational facilities and the acquisition, operation and maintenance of County beaches, inland regional park recreational facilities and community park sites in the unincorporated areas. At the end of FY 2004-05, there was an \$8,930 increase in fund balance. This increase resulted from a \$5,000 Educational Revenue Augmentation Fund (ERAF) rebated by the State due to a property tax ERAF shift and a \$1,800 grant for land purchases for the Freemont Nature Canyon and Modjeska Canyon Nature Preserve.

Other Governmental Funds

At the end of FY 2004-05, there was an increase in fund balance of \$119,892. In comparison to last year, both revenues and expenditures decreased in FY 2004-05. Other financing sources decreased by \$33,429 primarily due to no refunding bond issuances. Expenditures decreased by \$106,228 compared to last year. Last year's debt service payments were significantly higher due to a one-time refinancing of the outstanding bond debt for the Santa Ana Heights (SAH) project area. Other factors contributing to the reduction in expenditures were lower capital expenditures for the Theo Lacy Jail Facility and less operating transfers to the General Fund.

The following chart shows the fund balances for governmental funds for the current and previous fiscal year:

Comparative Fund Balance - Governmental Funds



Proprietary Funds

The proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the Airport and Waste Management operations, both of which are considered to be major funds of the County. Internal Service Funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

Comparative Analysis of Changes in Fund Net Assets

The following table presents the Enterprise Funds' actual revenues and other financing sources, expenses and transfers, and changes in fund net assets for the current and previous fiscal year:

**ENTERPRISE FUNDS
COMPARATIVE SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
For the Year Ended June 30, 2005**

	Revenues, Contributions and Transfers		Expenses and Transfers		Change in Fund Net Assets	
	2005	2004	2005	2004	2005	2004
Airport	\$ 110,324	\$ 99,776	\$ 78,835	\$ 76,932	\$ 31,489	\$ 22,844
Waste Management	124,706	118,026	102,510	82,956	22,196	35,070
Total	\$ 235,030	\$ 217,802	\$ 181,345	\$ 159,888	\$ 53,685	\$ 57,914

Airport

This fund accounts for major construction and self-supporting aviation-related activities rendered at John Wayne Airport (JWA), Orange County. Last year's increase in fund net assets was \$22,844; this year fund net assets continued to increase by \$31,489 primarily because of the following factors:

- A \$4,875 increase in rents and concession from airline rent, parking, car rental, and lease concessions due to the increased number of passengers and the level of traveler activities at the airport.
- A \$4,519 increase in grant revenues for the construction of new passenger security lanes, acquisition of a new aircraft rescue firefighting vehicle, remodeling of fire station #33 facility, rehabilitation of taxiway "E", reconstruction of Perimeter Road West, and security modifications at the terminal.
- A \$1,227 increase in interest revenue due to higher interest rates.

Waste Management

This fund is used to account for the operation, expansion, and closing of existing landfills and the opening of new landfills. Monies are collected through gate tipping fees, which users pay based primarily on tonnage. At the end of FY 2004-05, there was an increase in fund net assets of \$22,196, compared to the prior year change of \$35,070, primarily due to the following factors:

- A \$7,000 increase in expenditures for landfill closer and postclosure care costs.
- A \$6,200 increase in expenditures for settlement payments for postclosure care costs.
- A \$4,299 increase in interest revenues due to the upward trend of interest rates.
- A \$2,352 increase in transfers to County General Fund to pay bankruptcy related obligations.
- A \$1,675 increase in charges for services due to an increase in the amount of "in-county" tonnage disposed at the landfills.

GENERAL FUND BUDGETARY HIGHLIGHTS

This section provides a summary of the primary factors involved in the variances between: 1) the Original Budget and the Final Amended Budget; and 2) the Final Amended Budget and the Actual Amounts for the General Fund. In addition to the effects of expenditure-driven grants, the following information provides explanations for significant variances. Refer to the Budgetary Comparison Statement for details on this budgetary comparison.

Original Revenue Budget vs. Final Amended Revenue Budget

The following provides a summary of the primary factors attributable to the increase in the General Fund final amended budget revenues compared to the original budget revenues:

Taxes

- A \$120,000 increase in revenues in the County General Fund due to the State's implementation of the Property Tax-Vehicle License Fee (VLF) Compensation Fund, in which a major portion of VLF revenue would be eliminated and replaced dollar for dollar with property tax (See Note 1.L. for more backfill information). The VLF was originally budgeted in "Intergovernmental Revenues."

Intergovernmental Revenues

- An increased revenue budget in Sheriff-Coroner of \$16,382 for additional one-time grants, including Homeland Security Grants, the Urban Areas Security Initiative (UASI) Grant, and the Avoid South County Grant, which is a grant awarded by the Office of Traffic Safety to reduce drunk driving in South Orange County.
- An increase of \$9,180 in budgeted revenues in the Social Services agency to reconcile actual allocations for the Medi-Cal Program and to fund the administration of the In Home Supportive Services (IHSS) program.
- A \$13,900 increase in revenues in the Probation Department because the State decided to continue funding for the Temporary Assistance for Needy Families (TANF) program and the Targeted Case Management program. The State decided to continue funding these programs after the original budget was adopted.

Transfers In

- An increase of \$4,811 in the Watershed Management Program to ensure that the Net County Cost target set by the County Executive Office would be met.
- An increase of \$16,725 in the Health Care Agency (HCA) for reimbursement from the Tobacco Settlement Revenue (TSR) Special Revenue Fund for FY 2003-04 eligible expenditures for Emergency Medical Services and an increase in transfers from Purpose Restricted Special Revenue Funds for various public health programs.

Original Expenditure Budget vs. Final Amended Expenditure Budget

The following provides a brief summary of the primary factors attributable to the increase in the General Fund final amended budget expenditures compared to the original budget expenditures:

Miscellaneous

- Budget Appropriations increased by \$28,620 due to the County's debt prepayment (\$17,454) for debt defeasance strategy (Refer to Note 19, Subsequent Events, for more information), higher retirement rates (\$6,165), and to offset the property tax shift to the State (\$5,000).

Probation

- A \$12,544 increase in appropriations due to continued funding of the TANF and Targeted Case Management programs.

Sheriff-Coroner

- A \$14,065 increase was appropriated to fund capital projects and purchase equipment funded by the Homeland Security Grant.

Social Services Agency

- An increase of \$11,561 to fund increased wages and benefits for IHSS providers, 84 new positions for the Medi-Cal Program, an increase of allocations for the Promoting Safe and Stable Families Program due to a change in funding cycle, and an increase in allocations for the Child Abuse Treatment Program.

Final Amended Revenue Budget vs. Actual Revenue Amounts

The following information provides a summary of the primary factors that caused the variance in the General Fund actual revenues compared to the final amended budget revenues:

Taxes

- A \$24,131 positive variance in the County General fund due to higher than anticipated growth rate in the value of the secured property taxes, the new legislation for supplemental property tax in lieu of VLF, and higher than estimated housing sales.

Intergovernmental Revenues

- A \$9,241 positive variance in Probation because the State decided to continue funding for the TANF program.
- A \$7,852 positive variance in Sheriff-Coroner due to increased receipts from Proposition 172, a voter-approved measure passed in 1994 establishing a ½ percent (0.5%) sales tax on an ongoing basis for local public safety programs.
- A \$9,998 positive variance in the Social Services Agency due to deferred revenues recognized in FY 2004-05.

Transfers In

The following are a result of not transferring money from Purpose-Restricted Special Revenue Funds:

- A \$5,406 variance in the District Attorney Office due to Proposition 172 actual revenues exceeding the budgeted amount.
- A variance of \$37,735 in the Sheriff's Department due to savings from maintaining a higher than budgeted vacancy factor, the delay in opening the Theo Lacy Building B, and the implementation of cost saving strategies.
- A variance of \$17,046 in HCA because transfers from the TSR Funds and the Animal Shelter Fund were lower than budgeted.

Charges for Services

- A negative variance of \$2,101 in HCA due to savings in salaries and employee benefits and human services contracts for Medi-Cal funded services.
- A negative variance of \$6,828 in the Sheriff-Coroner and its court operations due to vacancies and a Worker's Compensation credit to the contract cities.
- A positive variance of \$5,051 in the Assessor's budget attributable to record real estate prices and market activity during the year.
- A positive variance of \$3,354 in the Registrar of Voters due to higher than anticipated revenue from election services and state reimbursement claims.
- A negative variance of \$1,993 in the Treasurer-Tax Collector due to a reduction of administrative fees.
- A \$6,015 negative variance in the Watershed Management Program due to non-reimbursable project expenses.
- A negative variance of \$2,755 in Employee Benefits because the 3% health and dental administrative fees charged to County departments were reclassified from charges for services to intrafund transfers.
- A negative variance of \$6,693 in the Resources and Development Management Department due to reduced expenditures from lower reimbursable indirect charges, less direct billable hours and more intra-agency billings, especially in the administrative functions.

Final Amended Expenditure Budget vs. Actual Expenditure Amounts

The following provides a summary of the primary factors causing the significant variance in the General Fund actual expenditures as compared to the final amended budget expenditures:

Miscellaneous

- A positive variance of \$10,454 was due to appropriations that were not needed for unanticipated expenditures for County programs. One of the purposes of this agency in the General Fund is to provide for such contingencies and is not anticipated to be spent unless the need arises. Another contributing factor causing the variance was the delay in acquiring new sites for the 800 MHz project.

Watershed Management Program

- A \$9,958 positive variance due to expenditures for some projects requiring professional and consulting services that were lower than anticipated and the deferral of various budgeted capital projects.

Capital Projects

- A \$32,151 positive variance due to a substantial number of unfinished multi-year complex capital projects which overlap fiscal years. Most of these projects will be completed in FY 2005-06, including the floor-by-floor rehabilitation of the Central Justice Center, the construction of the Youth Leadership Academy at Juvenile Hall, and the 800 MHz project.

Health Care Agency

- A positive variance of \$7,326 due to vacancies that reduced salaries and employee benefits, lower group insurance rates, as well as an unemployment insurance rebate.
- A \$25,363 positive variance due to lower than budgeted costs in TSR funded projects, contracts and price agreements, including the information technology price agreement, and various human services contracts.

Probation

- A positive variance of \$9,894 due to the deferral of a collection software module project and other information system projects, savings from the closure of Youth and Family Resource Centers, a reduction in the Juvenile Justice Crime Prevention Act Program, deferral of software license agreements and maintenance projects for the Los Pinos Conservation Camp, fewer California Youth Authority commitments, and the department operating with an 11% difference vacancy factor compared to a budgeted vacancy factor of 8%.

Sheriff-Coroner

- A \$25,551 positive variance due to deferrals in professional services, equipment, and special department expenditures because reimbursement from the Homeland Security Grant are expected to be paid in FY 2005-06.
- A \$9,735 positive variance due to maintaining a higher than budgeted vacancy factor and the defunding and deletion of positions recommended by the Blue Ribbon Committee.

Aid to Families with Dependent Children – Foster Care

- A \$14,892 positive variance due to decrease in caseloads for Federal and Non-Federal group homes, federal foster family agencies, and emergency assistance cases by moving children to family based settings that are less costly.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2005, the County's capital assets for both the governmental and business-type activities amounted to \$2,918,154 net of accumulated depreciation. The investment in capital assets includes land, structures and improvements, equipment, infrastructure (roads, bridges, flood channels, trails, traffic signals, and harbors), and construction in progress. The total increase in the County's investment in capital assets for the current year was 3% (a 4% increase for governmental activities and a 1% increase for business-type activities).

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

CAPITAL ASSETS
(Net of Depreciation)
June 30, 2005

	Governmental Activities		Business-Type Activities		Total		Increase (Decrease)
	2005	2004	2005	2004	2005	2004	% Change
Land	\$ 567,243	\$ 481,048	\$ 34,108	\$ 34,108	\$ 601,351	\$ 515,156	17%
Structures and Improvements	510,827	501,778	184,739	196,110	695,566	697,888	0%
Equipment	103,739	102,418	23,357	24,422	127,096	126,840	0%
Infrastructure	801,263	817,294	196,237	182,510	997,500	999,804	0%
Construction in Progress	427,674	418,347	68,967	62,837	496,641	481,184	3%
Total	\$ 2,410,746	\$ 2,320,885	\$ 507,408	\$ 499,987	\$ 2,918,154	\$ 2,820,872	3%

The following lists the significant expenditures for capital assets in FY 2004-05:

General Fund

- \$38,609 for a capital lease for a Social Services building.
- \$8,275 for the construction of three new housing units for the Youth Leadership Academy at Juvenile Hall, which will increase the capacity to 120 beds.
- \$2,030 for the purchase of a helicopter for the Sheriff Department.
- \$2,017 for the purchase of hazardous materials vehicles for the Sheriff Department.
- \$1,259 for the renovation of various County facilities to comply with the ADA requirements.
- \$1,204 for construction projects at the Theo Lacy Jail Facility.
- \$1,095 for planning and designing a new courthouse in South County, which includes master planning for Superior Court, and a possible civic center for the City of Laguna Niguel.
- \$1,040 for the purchase of a mainframe computer for the Sheriff Department.

Flood Control District

- \$70,841 for the acquisition of property rights for the Santa Ana River Mainstream/Prado Dam project.

800 MHz Countywide Coordinated Communications System

- \$1,786 for equipment and service enhancements for the Orange County Mutual Aid project funded by the Community Oriented Policing Services Interoperable Communications.
- \$1,607 for equipment and services to enhance countywide emergency preparedness funded by the UASI and Homeland Security grants.

Airport

- \$4,008 to remodel Fire Station #33.
- \$3,428 for construction of new passenger security lanes.
- \$2,798 to rehabilitate taxiway "E."
- \$2,410 to design an electric generation plant.
- \$1,241 to reconstruct the Perimeter Road West.
- \$1,183 construction of new flush mount fire hydrants.
- \$1,104 to design the new South Remain Over Night airplane parking.
- \$1,078 to install a temporary passenger waiting facility at the south end.
- \$1,025 for a new aircraft rescue firefighting vehicle.

Waste Management

- \$10,684 to expand the Frank R. Bowerman (FRB) Landfill.
- \$1,301 for the construction of the Lower East Perimeter Storm Drain and Access Project at Olinda Alpha Landfill.
- \$1,217 for construction management, quality assurance and quality control at FRB and Central Region landfills.

Additional information on the County's capital assets can be found in Note 4, Changes In Capital Assets, of this report.

Commitments for Capital Expenditures At the end of FY 2004-05, significant commitments for capital expenditures included the following:

- \$413,000 for the Santa Ana River Mainstream Project.
- \$18,721 to expand Laguna Canyon Road from State Route 73 to Interstate 405.
- \$8,184 for heating, ventilation, and air-conditioning improvements to comply with ADA at the Central Justice Center.
- \$7,134 for construction of the Youth Leadership Academy.
- \$6,256 for the Prima Deshecha Desilting Basin Improvement Project.
- \$6,173 for various flood control channel projects.

Additional information on the County's commitments for capital expenditures can be found in Note 14, Construction And Other Significant Commitments, of this report.

Long-Term Debt

At June 30, 2005, the County had a total debt obligation outstanding of \$1,345,761, excluding capital lease obligations, compensated absences and other liabilities. During the year, \$72,137 of the bonds were retired, which resulted in a net decrease of 5% on the County's outstanding bond obligation. The County is limited by law in issuing general obligation bonded debt to 1.25 percent of the last equalized property tax roll. However, this does not affect the financing of any of the County's planned facilities or services because as of the end of the fiscal year, the County had no net general obligation bonded debt. The County's debt obligations are in the form of revenue bonds, certificates of participation, and other forms of debt not covered by the general obligation debt limitation law.

The following table summarizes the County's outstanding bonds at June 30, 2005:

LONG-TERM DEBT BOND OBLIGATIONS

June 30, 2005

	Governmental Activities		Business-Type Activities		Total		Increase (Decrease)
	2005	2004	2005	2004	2005	2004	% Change
Revenue Bonds	\$ 261,180	\$ 268,607	\$ 181,240	\$ 196,300	\$ 442,420	\$ 464,907	(5)%
Certificates of Participation	589,909	619,394	--	--	589,909	619,394	(5)%
Pension Obligation Bonds	111,772	116,772	--	--	111,772	116,772	(4)%
Recovery Bonds	210,705	225,870	--	--	210,705	225,870	(7)%
Add: Premium on Bonds Payable	5,009	5,045	4,210	5,082	9,219	10,127	(9)%
Less: Deferred Amount on Refunding	(5,744)	(6,110)	(12,520)	(15,099)	(18,264)	(21,209)	(14)%
Total	\$ 1,172,831	\$ 1,229,578	\$ 172,930	\$ 186,283	\$ 1,345,761	\$ 1,415,861	(5)%

Additional information on the County's long-term debt activity can be found in Note 9 of this report.

Bond Ratings

The County continues to maintain the issuer ratings of Aa2 from Moody's Investors Service and A+ from Standard & Poor's. The 1995 Teeter Plan Revenue Bonds and the Orange County Development Agency (OCDA) 2003 Santa Ana Heights (SAH) Bonds are AAA insured with a municipal bond insurance policy, but are not currently rated (NR indicates Not Rated). The rating report cited the County's continued prudent fiscal management, evidenced by a strong fiscal position and disciplined adherence to its strategic plan, focusing on debt reduction, as well as the diversified and healthy local economy, as the basis for the rating. There were no changes in the County's underlying debt ratings as compared to the previous year.

The County maintains the following long-term underlying debt ratings:

LONG-TERM DEBT RATINGS

June 30, 2005

	Moody's	Fitch	Standard and Poor's
1995 Recovery Bonds	Aa3	NR	NR
1996 Recovery COPs	A1	AA-	NR
1991 Parking COPs	A1	NR	NR
OCDA Neighborhood Development and Preservation Project	A2	NR	A
2002 Lease Revenue Bonds	A1	AA-	A
OCDA 2003 SAH Bonds	NR	NR	NR
1996 Pension Obligation Bonds	Aa2	NR	NR
1997 Pension Obligation Bonds	Aa2	AA-	NR
1995 Teeter Plan Revenue Bonds	NR	NR	NR
2001 Lease Revenue Bonds	A2	NR	NR
Airport 1997 Revenue Refunding Bonds	Aa3	A+	A+
Airport 2003 Revenue Refunding Bonds	Aa3	NR	A+
IWMD 1997 Revenue Refunding Bonds	A2	A+	NR

OTHER POTENTIALLY SIGNIFICANT MATTERS

The County's management has determined that the following are significant matters that have a potential impact on the County's financial position or changes in financial position:

Governmental Activities

State Budget

On July 11, 2005, Governor Schwarzenegger signed the FY 2005-06 Budget Act. The FY 2005-06 Budget Act projects General Fund revenues of \$84,200,000, expenditures of \$90,000,000 and an ending reserve balance of \$1,300,000 (including an allowance for \$900,000 of tax refunds which the State may be obligated to make).

The Governor's original budget identified a budget shortfall of \$8,600,000 without implementation of the policy changes identified in the Governor's budget proposal. However, the upward revision in FY 2004-05 and 2005-06 projected tax revenues, among other factors, have permitted the Governor to address a smaller budget shortfall of \$6,000,000 and to maintain a \$500,000 reserve through \$6,500,000 of expenditure and savings "solutions" and without tax increases. The FY 2005-06 Budget Act also eliminates the proposed issuance of additional "Economic Recovery Bonds," which were to provide \$1,700,000 to the General Fund in the original budget proposal.

The revenue increase forecasted by the FY 2005-06 Budget Act forecasts gains in the personal income tax, sales and use tax and corporation tax. Personal income tax revenues are forecasted to be \$41,900,000 in FY 2004-05 and \$43,200,000 in FY 2005-06. This forecast assumes a percent change increase in personal income tax revenue of 15.1% for FY 2004-05 and 3.2% for FY 2005-06. Sales and use tax revenue is forecasted to be \$25,100,000 in FY 2004-05 and \$27,000,000 in FY 2005-06, a 7.6% increase. Corporation tax revenues are expected to total \$7,600,000 in FY 2004-05 and \$8,800,000 in FY 2005-06, a 15.8% increase.

The FY 2005-06 Budget Act assumes local government revenues will increase during the next few years due in part to increases in property taxes and sales and use tax to local governments. Property taxes and sales and use tax are major sources of discretionary revenue for local governments, including the County. The FY 2005-06 Budget Act projects property taxes to local governments to be approximately \$22,980,000, an increase of 14% above the amount expected to be received in the FY 2004-05, as a result of the strong housing market and increased sales of non-residential real estate. The sales and use tax in FY 2005-06 is also expected to increase by approximately 4.5% above the amount expected to be received in FY 2004-05. The sales and use tax is expected to provide local governments with over \$4,000,000 for discretionary purposes, in addition to \$2,700,000 for public safety, \$2,700,000 for health programs and \$1,300,000 for county transportation purposes. In addition, the FY 2005-06 Budget Act projects VLF revenues, which provide funding for local health programs, to increase by 4% during the next two years.

Certain features of the FY 2005-06 Budget Act affecting counties include the following:

- The FY 2005-06 Budget Act includes funding in various budgets that support activities by local government agencies where the local agencies have significant discretion over the use of the funds. Such programs include law enforcement, realigned health and mental health services, public health, property tax administration, Williamson Act open space preservation contracts, libraries, recreational facilities, flood control, and housing. Funding for these programs will be approximately \$5,600,000 in FY 2005-06, which represents a reduction of approximately \$368,000 from the amount expected to be received in FY 2004-05 (based upon May Revision estimates).
- The FY 2005-06 Budget Act includes funding for local governments to make up the difference between the 0.65% rate of the VLF and the previous 2% rate through a reallocation of property tax from schools and community colleges to cities and counties. The Budget Act also includes the accelerated repayment of all of the VLF revenue that the local governments did not receive in FY 2003-04 due to the suspension of the VLF backfill, which was not required to be paid until FY 2006-07. The County received repayment of the VLF gap loan from the State on July 26, 2005, resulting in an additional \$26,506 of additional resources to the County.
- The FY 2005-06 Budget Act fully funds Proposition 42 (transportation) funding, at approximately \$1,300,000. Proposition 42 funds have been diverted to State General Fund use in prior years.

Long-Term Financial Planning

Funding of Orange County Employees Retirement System

In 2004, the Orange County Employees Retirement System (OCERS) retained the Segal Company to complete an actuarial valuation of OCERS as of December 31, 2004. The recommendations of the Segal valuation were adopted by the OCERS Board on October 24, 2005. The Segal valuation determined that the ratio of the valuation assets to actuarial accrued liabilities decreased from 78.5% as of December 31, 2003 to 69.1% as of December 31, 2004. The County is working with the departments to develop a Budget Reduction Plan for anticipated increases in FY 2006-07 retirement costs. Detailed information on OCERS and the actuarial assumptions are available in Note 17, Retirement Plans.

Funding of County of Orange Retiree Medical Plan

The County is currently developing a strategy to address the funding and structure of the Retiree Medical Plan as well as wellness, consumer education and other programs designed to control medical premium costs. Current Memoranda of Understanding with bargaining units run through FY 2007-08 and do not include re-openers for Retiree Medical Plan negotiations. More information on the Retiree Medical Plan is available in Note 18, Post Employment Health Care Benefits.

County Accounting and Personnel System (CAPS) Upgrade

CAPS is a vital part of the County's infrastructure that is needed for business processes such as financial planning and budget development, maintaining the County's financial records, collecting costs for federal and state claiming, procuring goods and services, paying vendors, processing the County's payroll, and administering enterprise-wide human resource functions. CAPS maintains financial records for the County's budget of approximately \$4,800,000 and maintains human resource records and processes payroll for a work force of over 18,000 employees.

CAPS is based on 1980s technology and is becoming costly to maintain and operate. In addition, the vendor has informed the County that it will discontinue support of its Advantage products, within the next three to five years. If the County does not take some action with the Advantage products after the vendor discontinues support system operations, maintenance costs will grow, the risk of the systems not functioning properly will increase, and ultimately the system will become technologically obsolete and unsupported.

The County is in the process of conducting a strategic assessment to identify the County's business processes, develop a strategic-level needs assessment for these business processes, identify the problems with the current system in meeting the County's business needs, develop a business case for taking action, and identify and analyze viable alternatives.

The results of the assessment have been presented to the CAPS Steering Committee and a more detailed assessment of two possible alternatives is under way. This assessment is expected to be completed by the end of December 2005. Based on the alternatives selected, requests for proposals will be issued to source the solution. Costs are expected to vary greatly and are expected to range from as little as \$5,000 to over \$50,000 depending on the selected alternative. Implementation of a solution could take from four to five years.

Assessment Tax System Upgrade

The County's property tax assessment, collection and allocation system processes approximately \$3,600,000 annually in property taxes for the cities, school districts and special districts within the County. The system was developed in the late 1980s and early 1990s in what is now an obsolete programming language that is becoming increasingly difficult to support. Given the critical nature of the application, its replacement is considered a strategic priority. A request for proposal to conduct a needs assessment of the property tax system was issued and contract negotiations are under way with the recommended vendor. The contract is expected to be finalized by January 2006, at which time work will commence.

The needs assessment is expected to last one year and will result in a requirements document that will be used for sourcing services to develop the replacement application. The development and deployment of the application is expected to take from three to four years at a cost of approximately \$18,000 to \$21,000.

Requests for Information

We hope that the preceding information has provided a general overview of the County's overall financial status. For questions or comments concerning information contained in this report, please contact the Auditor-Controller's Office, County of Orange, 12 Civic Center Plaza, Santa Ana, CA 92702 or you can access our website at <http://www.ac.ocgov.com>.