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MAYOR PRO TEM
Lisa Bist
COUNCIL MEMBERS
Claudia C. Alvarez
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Mike Garcia
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CITY OF SANTA ANA

CITY MANAGER
David N. Ream
CITY ATTORNEY
Joseph W. Fletcher
CLERK OF THE COUNCIL
Patricia E. Healy

November 15, 2006

To the Honorable Mayor, Members of the City Council, and Citizens of the City of Santa Ana:

State law requires that all general-purpose local governments publish within six months of the close of each fiscal year a complete set of financial statements presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with auditing standards generally accepted in the United States of America by a firm of licensed independent certified public accountants. Pursuant to that requirement, we hereby issue the comprehensive annual financial report of the City of Santa Ana for the fiscal year ended June 30, 2006.

This report consists of management's representations concerning the finances of the City of Santa Ana. Consequently, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of the City of Santa Ana has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the City of Santa Ana's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the City of Santa Ana's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The City of Santa Ana's financial statements have been audited by Moreland & Associates, Inc., a firm of licensed independent certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the City of Santa Ana for the fiscal year ended June 30, 2006 are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the City of Santa Ana's financial statements for the fiscal year ended June 30, 2006 are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the City of Santa Ana was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the City of Santa Ana's separately issued Single Audit Report.

GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of the Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Santa Ana's MD&A can be found immediately following the report of the independent auditors.

Profile of the Government

The City of Santa Ana, incorporated in 1886, is located in Orange County, California, which is considered to be one of the top growth areas in the state, and one of the top growth areas in the country. The City of Santa Ana currently occupies a land area of 27.2 square miles and serves a population of 351,697. The City of Santa Ana is empowered to levy a property tax on both real and personal properties located within its boundaries. Increases in the property tax rate are subject to voter approval. It also is empowered by state statute to extend its corporate limits by annexation, which occurs periodically when deemed appropriate by the governing council.

The City of Santa Ana has operated under the council-manager form of government since 1952, having been one of the first in the state to adopt this form of government. Policy-making and legislative authority are vested in a governing city council consisting of the mayor and six other members. The City Council, among other things, is responsible, for passing ordinances, adopting the budget, appointing committees, and hiring the City Manager, City Attorney, and the City Clerk. The City Manager is responsible for carrying out the policies and ordinances of the City Council, for overseeing the day-to-day operations of the City, and for appointing the heads of the various departments. The council is elected on a non-partisan basis. Council members serve four-year staggered terms, with three council members elected every two years. The mayor is elected to serve a two-year term. The mayor and all council members are elected at large.

The City of Santa Ana provides a full range of services, including police and fire protection; the construction and maintenance of streets and other infrastructure; recreational activities and cultural events. The City of Santa Ana is also financially accountable for three legally separate entities: The Community Redevelopment Agency of the City of Santa Ana, the Housing Authority, and the Santa Ana Financing Authority, each of which are reported separately within the City of Santa Ana's financial statements. Additional information on all three of these legally separate entities can be found in Note 1A in the notes to the basic financial statements.

The annual budget serves as the foundation for the City of Santa Ana's financial planning and control. All agencies of the City of Santa Ana are required to submit requests for appropriation to the City Manager on or before April 30th of each year. The City Manager uses these requests as the starting point for developing a proposed budget. The City Manager then presents this proposed budget to the council for review prior to June 15. The council is required to hold public hearings on the proposed budget and to adopt a final budget by no later than July 31. The appropriated budget is prepared by fund, program (e.g., police patrol), and department (e.g., police). Department heads may make appropriation adjustments within a department. Appropriation adjustments between departments; however, require the special approval of the City Council. Budgetary comparisons are provided in this report for each individual governmental fund for which an appropriated annual budget has been adopted. For the general fund, this comparison is presented on page 107 as part of the basic financial statements for the governmental funds. For governmental funds, other than the general fund, with appropriated annual budgets, this comparison is presented in the governmental fund subsection of this report, which starts on page 108, as well as on pages 120 through 123.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City of Santa Ana operates.

Local economy. Orange County is the fourth richest county in the nation with a Gross County Product of \$160.7 billion. The City of Santa Ana is known as the heart of Orange County and the center of government, commerce and transportation. Santa Ana is home to over 15,000 businesses with the top 25 businesses generating more than 29% of the jurisdiction's total sales/use tax revenue. Major companies with headquarters and divisions located within the City's boundaries include computer hardware and software manufacturers, electrical controls and electronic component manufacturers, food manufacturers, and several financial and insurance institutions. A key component in enhancing the City's economic base is its focus on business attraction and retention program. The City's designation as an Enterprise Zone provides a competitive edge in attracting new businesses to the area. The designation enables the City to offer significant state tax credits and other financial incentives resulting in over 27,000 new employees hired with over 700 companies earning tax credit vouchers. Over the past few years, these incentives were instrumental in several companies relocating to and or expanding their businesses in Santa Ana. Private sector developers also recognize the benefits of building in Santa Ana. Several new commercial and residential projects are currently under development in the city, which will result in over 1,500 new residential units and over 30,000 square feet of new retail space.

Long-term financial planning. Ensuring the City's financial security is a fundamental responsibility of the administration of our organization. In addition to the ongoing fiduciary functions, strategy for our long-term financial ability to deliver quality services includes; aggressively seeking grant monies available to local government to fund capital projects or enhance operations; refinancing debt to reduce annual payments by capitalizing on lower interest rates; actively pursuing competitive bids for goods, services, and capital projects; providing adequate reserves for liability and workers compensation funds; and minimizing credit and market risks while maintaining a competitive yield on the City's investment portfolio. In 2006-07, the City will continue to research grant opportunities provided by the Federal and State governments and aggressively apply for programs that are in alignment with our goals. Through the efforts of our departments and the citywide grants task force, the City secured \$62.36 million in competitive grant funding in fiscal year 2005-2006. Also through the efforts of the Santa Ana Police Department, the Department of Homeland Security has awarded the City the Fiscal Year 2006 Urban Area Security Initiative Grant for \$8.22 million. This financial assistance will provide funding to address the unique planning, equipment, training, and exercise needs of large urban areas and to assist the City in building an enhanced and sustainable capacity to prevent, respond to, and recover from threats or acts of terrorism. Also in fiscal year 2005-06, through the efforts of the Public Works Agency, the Orange County Transportation Authority has awarded \$125 million from the Gas Tax Subvention fund for the Bristol Street improvement projects.

The City's population has increased by almost 15% in the last ten years. It is anticipated that Santa Ana will continue to experience modest population growth through 2025. Providing and maintaining first-rate infrastructure and community facilities is one of the primary goals of the City's administration. One of the priorities under this goal is to ensure proper levels of maintenance for our infrastructure, public buildings, parks and neighborhoods. The \$81.3 million Capital Improvement Program for the 2006-2007 fiscal year includes: the continuation of our commitment to neighborhood improvements, including over \$1.7 million for neighborhood street improvements, street resurfacing,

and reconstruction of damaged curbs and sidewalks; \$20.5 million for street reconstruction, resurfacing and arterial widenings; \$2 million for improvements at City parks; \$50 million for arterial widening improvements of which \$46 million was awarded from the Orange County Transportation Authority gas tax subvention for the Bristol Street corridor widening project; \$1 million for improvements to the sewer systems; \$3.9 million for improvements to the water system; and \$8.1 million for city facility underground utilities and traffic improvement.

Cash management policies and practices. Cash temporarily idle during the year was invested in certificates of deposit, obligations of the U.S. Treasury, securities issued by federal agencies commercial paper, corporate bonds, repurchase agreements, and the State Treasurer's investment pool. The maturities of the investments range from 3 days to 5 years, with an average maturity of 13 months. The average yield on investments was 3.80 percent. Investment income includes the increase in the fair value of investments. Increases in fair value during the current year, however, do not necessarily represent trends that will continue; nor is it always possible to realize such amounts, especially in the case of temporary changes in the fair value of investments that the City intends to hold to maturity.

Risk management. The City of Santa Ana has a comprehensive risk management program for workers' compensation, liability and property risks. As part of this comprehensive plan, resources are being accumulated in the self-insurance fund to meet potential losses. In addition, various risk control techniques, including employee accident prevention training, have been implemented to minimize accident-related losses. Insurance coverage is maintained for workers compensation claims greater than \$500,000. The City is currently self-insured for liability claims up to \$1 million. In FY 88-89, the City entered the Big Independent Cities Excess Pool (BICEP), a risk-sharing joint powers authority with four other cities, which has assumed loss risk for liability claims between \$1 million and \$25 million against the City. BICEP, in turn, has obtained excess insurance coverage for liability claims between \$2 million and \$22 million. In 1993, the City became a charter member of the Public Entity Property Insurance Program (PEPIP). Current PEPIP limits are \$750 million per occurrence for "all risk", and \$82.5 million for flood coverage. Additional information on the City of Santa Ana's risk management activity can be found in Note 4A of the notes to the basic financial statements.

Pension and other post-employment benefits. The City has contracted with the California Public Employee's Retirement System (CalPERS) to provide certain retirement, disability, death and survivor benefits for full-time city employees. The annual actuarial valuation of CalPERS continues to reflect relative stability in the City's and employees' funding of the system. The City's actuarial determined contribution rate for Safety members was 23.464% effective rate for fiscal year 05-06. The contribution rate for miscellaneous members has remained at a 7.984% effective rate for fiscal year 05-06.

The City of Santa Ana also provides postretirement health and dental care benefits for certain retirees and their dependents. As of the end of the current fiscal year, there were 145 retired employees receiving these benefits, which are financed on a pay-as-you-go basis. Current GAAP does not require governments to report a liability in the financial statements in connection with an employer's obligation to provide these benefits.

Additional information on the City of Santa Ana's pension arrangements and post-employment benefits can be found in pages 100 through 101 in the notes to the basic financial statements.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Santa Ana for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. This was the twenty-eighth consecutive year that the government has received this prestigious award. In order to be awarded a Certificate of Achievement, the government published an easily readable and efficiently organized CAFR. This report satisfied both GAAP and applicable legal requirements. The same report also received an award for "Outstanding Financial Reporting" from the California Society of Municipal Finance Officers (CSMFO).

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR 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.

In addition, the city also received the GFOA's Distinguished Budget Presentation Award for its fiscal year 2005-06 budget document. In order to qualify for the Distinguished Budget Presentation Award, the City's budget document was judged to be proficient in several categories, including as a policy document, a financial plan, an operations guide, and a communications device. The same budget document also received an award for "Excellence in Budgeting" from the CSMFO. The City's 2006-07 budget has been submitted to both GFOA and CSMFO to determine its eligibility for another award.

The preparation of this report would not have been possible without the efficient and dedicated services of the staff of the Finance Department. We would like to express our appreciation to all members of the department who assisted and contributed to the preparation of this report. Credit also must be given to the Mayor and the City Council for their unfailing support for maintaining the highest standards of professionalism in the management of the City of Santa Ana's finances.

Respectfully submitted,



David N. Ream
City Manager



Francisco Gutierrez
Executive Director
Finance & Management Services