



COUNTY OF ORANGE

OFFICE OF THE TREASURER-TAX COLLECTOR

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July 10, 2002

The Honorable Cynthia P. Coad
Chair, Board of Supervisors
10 Civic Center Plaza, Fifth Floor
Santa Ana, CA 92701

Dear Supervisor Coad:

It is with great pleasure that I submit this annual report to you, our participants, and the residents of the County of Orange for the fiscal year ended June 30, 2002. In addition, a complete version of this report is also available for download at our website <http://www.oc.ca.gov/treas/>.

This past year has been very productive and I am very pleased with the results of the efforts achieved by my Treasurer and Tax Collector staff members.

The fiscal year started with a “plane lands safely” story.

On July 18, 2001, we received our principal and interest from Edison International, as scheduled, and as predicted and announced through our communications to the Board of Supervisors. Accordingly, Fitch Ratings restored our Educational Pool’s rating back to “AAA/V-1+” after their previous hasty downgrade in January.

This ended a rather unique chapter in our office’s post-bankruptcy period. With the opportunity of hindsight, there certainly was more to California’s energy crisis than met the eye. With only one or two exceptions, all of our participants were cool, calm and collected and operated in a spirit of cooperation as we communicated our efforts in this regard. Many thanks go to Chriss Street of Chriss Street & Company and David Neier of Greenberg Traurig for their professional counsel and expertise.

On September 11, 2001, one of the most fateful days in my lifetime, our investments were uninterrupted and our financial professionals performed satisfactorily under the circumstances.

This year our first two cities, Villa Park and Tustin, were approved to participate in our local government investment pool. This speaks volumes about the progress the County has made and we should be proud of these accomplishments.

Investment Policy Statement

The December submission of our annual investment policy statement review provided the following modifications:

1. We now provide the qualifications of any investment staff when they are hired or promoted. We also provide the status of our staffing in this annual report.
2. Thompson BankWatch was acquired by Fitch Ratings, so all references have been updated. However, we now require two satisfactory ratings from Fitch, their traditional short-term rating and their recently acquired individual bank rating.
3. We eliminated references to Government Code Section 53635, as it was merged into Section 53601 with Assembly Bill 609. (This was a legislative change that our office had pursued for many years and was accomplished with the collaboration of Thomas Jeffrey of the City of Palm Desert, for the California Municipal Treasurers Association and myself and Tom Ford, Sonoma County Treasurer-Tax Collector, for the California Association of Treasurers and Tax Collectors.)
4. We made some minor grammatical changes for our Medium-Term Notes section, including memorializing an internal policy of requiring an “AAA” rating for holdings in excess of 13 months.

Unfortunately, two minor amendments were not approved. The first was an industry term update changing “issuing corporations” to “issuers.” Although not critical to our operations, we may reintroduce this change in the future. The other was the ability to acquire credits with a “credit watch-negative” status only if the rating was currently at the highest possible level, i.e. “A-1+.” This is an obvious deficiency in our current policy that should be addressed and will receive further analysis by my Treasurer’s Advisory Committee in the future. The Board of Supervisors deferred this recommendation at the December meeting until late March. However, both the Treasurer’s Advisory Committee and Treasury Oversight Committee advised that it be dropped for the time being (see our website for a copy).

Treasury Oversight Committee

The Treasury Oversight Committee continues to meet on a quarterly basis to assist in the annual review of the investment policy statement and our compliance to it. The compliance audit performed by Internal Audit for the year ended December 31, 2000 was completed. The audit for the year ended December 31, 2001 is in the process of pursuing bids from outside independent Certified Public Accounting firms. Internal Audit’s rates have risen to more than \$100 per hour with 800 hours budgeted for this task. We have found that an outside firm can provide this service at a much lower cost and would represent a higher level of accountability.

I wish to acknowledge my appreciation to Charles Schroeder, Committee Chairman, Robert Fauteux, Committee Vice Chairman, Michael Schumacher, County Executive Officer, David E. Sundstrom, Auditor-Controller, and Bill Habermehl, Superintendent of the Orange County Department of Education for their assistance in this critical area of responsibility. A copy of their annual report to the Board of Supervisors is included in this report (see XIV—Treasury Oversight Committee).

Treasurer's Advisory Committee

The Treasurer's Advisory Committee continues to be a professional resource in critiquing and constructing the technical aspects of the investment policy statement. Their collective wisdom has been an invaluable asset to the County. They have been with me since my appointment to this office in 1995. In order to give some of them a well-deserved rest we instituted terms this year. Accordingly, The Honorable Jeffrey M. Thomas, Mayor of the City of Tustin, and Bruce A. Hughes, Esq., C.P.A., have completed their terms of service effective December 31, 2001. I am deeply appreciative of all their time, expertise and devotion to the task of making this the best Treasurers Department that we can possibly be.

I would also like to extend my deep appreciation to George Jeffries, Chairman, Wendy Margarita, Ed.D., Vice Chairman, Clyde E. Kendzierski, and Blake E. Christian, C.P.A. And I wish to welcome Timothy Tunney, Jerry Slusiewicz and the Honorable Ken Henderson to our Committee.

Investment Management Committee

Our investment management committee has completed another admirable year in its market research. This year the committee accurately predicted all but one regularly scheduled Federal Open Market Committee (FOMC) meeting decisions on interest rates prior to their meetings. This brings our record of precisely anticipating the FOMC's decisions to 52 out of 55. This diligence to economic and market analysis has generated additional basis points in yield for our participants. This is especially true as it relates to our establishment of the Extended Fund.

The information provided in each of our monthly reports, including this one, has been informative and displayed a professional acumen concerning the direction of short-term interest rates. Accordingly, our investment performance was enhanced as we benefited from a longer weighted average maturity as a result of the research provided. It is a pleasure to state in our monthly reports that the charts, tables, graphs and numerical representations have been provided to our readers solely as a general overview of the economic and market conditions which the Treasurer utilizes in making investment decisions.

The investment staff, along with our volunteer student interns, continues to compile and update an impressive database of issuers whose capital assets and credit ratings are continually reviewed, researched and approved as qualifying under our overly restrictive policies.

Legislative Pursuits

The 2001 Legislative Session found the following success stories. On July 23, 2001, the Governor signed Assembly Bill 594, which allows taxpayers to pay property taxes electronically until midnight of the due dates. Our appreciation goes to Assemblyman Tom Harman for carrying this bill.

On July 26 the Governor signed Assembly Bill 609 referred to in the above Investment Policy Statement section. We are very pleased to have played a significant part in this effort. And, on August 13, the Governor signed Senate Bill 210, which permits the use of Controlled Disbursements, a check clearing technique. Since becoming effective on January 1, 2002, our Cash Manager, Kim Hansen, has been

working closely with the Auditor-Controller to implement this process. This was another multi-year effort that has finally come to fruition which will enhance our cash management efficiencies.

For the 2002 Legislative Session, our Department's legislative submissions for the California Association of Treasurers and Tax Collectors (the "Association") to consider were approved. Of the eight, three were related to the treasury functions of my office.

1. Eliminate Government Code Section 27063.

We resubmitted this proposal. However, it was pulled from the Association's Omnibus bill by the Senior Consultant to the Senate Local Government Committee because we had a similar bill approved in the last three years.

Every month my office prepares a Statement of Cash Receipts and Disbursements for the Board of Supervisors and the Clerk of the Board. I do not believe it is very useful to its users. In the last Legislative Session we were able to add that the Auditor-Controller could also prepare this report. Unfortunately, subsequent to its passage, our Auditor-Controller has not been able to provide a more useful report. Therefore, we mutually agreed to eliminate the requirement in total. We will attempt to submit this proposal again in the future, but through a stand-alone bill.

2. Add Funding Agreements as an eligible investment opportunity.

We attempted to pursue this utilizing the Association's Omnibus bill, which did not work. We will attempt to submit this proposal again in the future, but through a stand-alone bill.

3. Resubmission of a money market option.

This year we pursued this as a stand-alone bill, Assembly Bill 2182, which is being carried by Assemblyman John Campbell (R-Irvine). This legislation would allow County Treasurers to operate and invest their funds in a manner similar to Rule 2a-7 under the Federal Investment Company Act of 1947. This bill has passed both the State Assembly and the State Senate, without opposition, and awaits the signature of the Governor.

By way of information, we also have one of our tax related legislative proposals in a stand-alone bill that is of note. It is Senate Bill 1494 and is being carried by Senator Dick Ackerman (R-Fullerton). It expands the definition of what is included in a lien and is in response to a recent litigation setback with the FDIC. This bill has passed both the State Senate and the State Assembly, also without opposition, and awaits the signature of the Governor.

Compliance

Our ability to monitor the investment policy statement compliance has been documented in the regular internal noncompliance report summary, including our prompt rectification, provided in each monthly report. Our compliance is also documented in Fitch's quarterly reports, which are

included in our monthly reports in a prompt manner.

Due to the recent accounting irregularities, we have mutually agreed with Fitch Ratings that it would be best to have a non-rating firm review our quarterly compliance. Accordingly, we will be engaging an outside Certified Public Accounting firm for this procedure. It is anticipated that it will be the same firm that performs our annual compliance audit (see "Treasury Oversight Committee").

Staffing Updates

We experienced only one key staffing change and it was in the Tax Collector's office. Our Collections Manager, Sheila Fisher, was able to obtain a better paying position, overseeing less staff, with a local credit union. We are nearing the completion of our recruitment process for her successor.

We were pleased to recruit Julia Xue to our new Financial Analyst position in August. She is doing a great job as a member of the team of those to whom authority has been delegated to buy and sell portfolio holdings.

Annual Business Plan

We usually use this annual report to provide a copy of our annual Business Plan. The Business Plan clearly delineates the tasks performed by this department and discusses our plans for the current calendar year. It also provides a detailed explanation of our performance measurements and our efforts to achieve them. However, we don't have enough room. Please see our website under the March 31, 2002 report.

Treasurer's Conference

On February 7, 2002, our office hosted the fourth annual Orange County Treasurer's Conference. The conference, entitled "2002: An Orange County Adventure," was well attended and received some of the most positive feedback ever from our attendees. Our Host Committee performed in a superlative manner and is already in the progress of planning next year's potentially expanded event, scheduled for February 6, 2003.

GASB 31

Our conservative Money Market Investment Pools provide a safe, liquid, and competitive money market yield at a net asset value in the \$1 range. The investments are marked-to-market on a daily basis and comply with Governmental Accounting Standards Board (GASB) 31, which became effective on June 15, 1997. As of June 30, our Extended Fund was also at a comfortable net asset value of \$1. Accordingly, those participants required to prepare their Comprehensive Annual Financial Reports, including the County, are not required to report a fair market adjustment for the fiscal year ended June 30, 2002.

Apportionment of Commingled Pool Interest Earnings

We have prepared a forecast for the timing of the County Pool's April and May 2002 interest apportionments. We anticipate posting the April and May interest apportionments to participants' cash accounts in the County general ledger by approximately July 9 and August 1 respectively.

Treasury Workstation

After preparing a comprehensive Request for Proposal, we concluded that the responses were not matching our prerequisites. Accordingly, we retrenched and restructured our expectations. After further analysis of current products in the marketplace we pursued a different tack and came to a satisfactory result.

We have selected and procured Sungard's Quantum Treasury Management System, which will be implemented with an interface to Bloomberg's Trade Order Management. The new system will provide a Straight Through Processing, end-to-end solution for the County's investment and treasury accounting requirements. The system is in the configuration and testing phase and is scheduled to go live on October 1, 2002.

Banking Change

During this fiscal year we moved our banking services to Wells Fargo, effective July 1. We appreciate the cooperation shown by all of the County's departments and the Department of Education during this transition period.

Economic Observations for the Year

These past twelve months have seen cascading interest rate easings and a dramatic change in the yield curve, adding to the excitement of this very unique fiscal year.

The elusive "light at the end of the tunnel" was partially visible to the financial markets in June 2001. Even though the economic news was mixed, the consumer remained vigilant as equity markets showed some weakness. The unprecedented events of September 11 quickly propelled the U.S. economy into a downward spiral.

The economic effect of these attacks caused massive layoffs, reduced spending, business closures and a severe jolt to the nation's psyche. The FOMC responded by quickly decreasing interest rates 100 basis points. Increased government spending was also part of the mix. Billions of dollars flowed back into the economy from the anti-terrorist war efforts and the new Department of Homeland Security. In addition to the one-time income tax rebate checks, consumers would soon see a decrease in their payroll withholding.

It was anticipated that the breathtaking scale of monetary and fiscal stimulus would guarantee a powerful recovery. To be sure, the 6.1% Gross Domestic Product (GDP) for the first quarter was much higher than anyone expected. The consumer was back and spending with abandon.

In addition to the consumer, this explosive momentum reflected a reduced need for manufacturers to pare inventories. The economy began to stall, during the second quarter, as expectations for inventories (Exhibit 1), capital spending (Exhibit 2), and job creation (Exhibit 3) failed to emerge.

Payrolls continue to lag the recovery with recent gains considered only marginal. A pick up in capital spending is likely to be gradual given that capacity utilization levels (Exhibit 4) and reduced equity valuations tend to restrain business investment. However, the positive effect from home price appreciation and improved cash flows from new mortgage refinancing activity will keep consumer attitudes upbeat. Accordingly, continuing economic growth will pave the way to resumption in business confidence.

Because of the Extended Fund's longer maturity limits, the investment team locked in higher interest rates before the latest period of historically low short-term rates. Our diligent economic and investment analysis has enabled the Treasurer's Investment Pool to realize an enhanced yield throughout the year.

At the June 26 meeting, the FOMC commented, "Economic activity is continuing to increase," but tempered its assessment by also stating "the degree of strengthening remains uncertain." The Treasurer's Investment Management Committee expects the FOMC to remain in a wait and see approach for the next several months with a mindset that any calls for interest rate hikes look premature.

Tax Collection

We have encouraging news to report on the tax collection endeavors of our department, as we continue to exceed State property tax collection rates. As of June 30, 2002, we expect to collect \$2.9 billion, which represents a 6.9 percent increase over last year. Our secured collection rate ranking is the sixth highest of the 58 Counties, with a 98.5% collection rate for the 2000-01 fiscal year. Thanks to the diversified economic conditions of businesses in Orange County, taking into account the recent economic slowdown, our unsecured business property tax collection rate was 96.20% for the 2001-02 fiscal year, compared to 97.39% for the last tax year. The reduction in our collection percentage is attributed to a 17% increase in the number of bankruptcy filings this year over last.

Technology enhancements continue to be accomplished in our efforts to improve collections and taxpayer service levels. The most significant accomplishment was the implementation of a property tax information website in September that provides property tax amount information for the Secured and Supplemental property tax rolls. In addition, we provided both Electronic Check and Credit Card payment enhancements during March and April. The response by the public has been very positive with 280,000 website inquiries in April, alone. We also have begun the process of converting the Assessment Tax System data base from DataCom DB to DB2. This project is scheduled for completion in fiscal year 2003 and will provide improved database capabilities, including Web development tools, not currently available with the existing database.

Working as a team player with the appropriate property tax interfaces continued to be a priority. We reached out to the Title Company industry and established semi-annual interface meetings to enhance communications and resolve mutual tax collection problems in a positive manner. In fact, the success of the property tax bill website is due in large part to the suggestions and sharing of information gathered from

these meetings prior to the final design of the website. Accordingly, we are very appreciative of the title company personnel that participated in these meetings.

Training of staff and promoting a healthy work environment for employees has been accomplished with the lead of our Human Resources manager and her staff. An outside training consultant has been retained to conduct individual and group training sessions that promote employee self-improvement in their personal and business lives. In addition, most of our departmental staff have attended small group training workshops conducted by our HR manager.

Our Public Information staff continues to provide the best service possible. We hired eight extra-help staff to improve public service levels during peak periods. This has allowed us to increase our telephone answering capabilities by 20 percent or 500 calls on a peak day.

Finally, we have made significant progress in seeking Board of Supervisor approval for the establishment of a Penalty Review Board. The Penalty Review Board will provide taxpayers with an independent review process for penalty refund appeals. Their purpose will be to make recommendations to the Board of Supervisors on penalty waiver requests previously denied by the Treasurer-Tax Collector. This endeavor should be implemented in the next fiscal year.

Other County Involvements

I have the privilege of serving as a board member of the Orange County Employees Retirement System. This Board meets monthly, and I have served as Chairman of the Additional Retiree Benefit Account (ARBA) Ad Hoc Committee, which has sunset, and the Audit Oversight Committee, which is expanding with the recent addition of an Internal Auditor for the system. I also serve as an ex-officio member of the County's Public Financing Advisory Committee, which meets biweekly, and as a member of the County's Audit Oversight Committee, which meets quarterly. However, I have requested that my membership on this committee be terminated.

I am pleased to announce that on March 5, 2002, I was re-elected to serve in this position for another four years. After serious consideration and lengthy deliberation with my family, it appeared appropriate to stay one more term in this position. Accordingly, I look forward to continuing the progress that we have been making in this department and to continue the wonderful relationships that I enjoy with my staff.

Other Involvements

In consideration of staying in this position for four more years, I consented to serving on the Board of Directors of the California Association of County Treasurers and Tax Collectors. I look forward to utilizing my seven years of experience in this endeavor and anticipate that it will benefit the citizens of our county.

Treasurer's Report

In order to assist you in reading this report, please note that the current balances reflect the investments recorded in the portfolios for each particular fund for the year ending June 30, 2001. Each money market fund has an average maturity of less than 90 days, with a net asset value (NAV) falling within the range of \$0.9950 and \$1.0050. The extended fund will have an average maturity of up to 549 days and a fluctuating NAV. All investments are marked to the market at the end of the reporting period due to the narrow valuation range prescribed by the Pools' Investment Policy Statement.

The reports reflect the par value (face value), the book value (cost to the County of the investment) and market value (the price of each security at the close of the market on the last trading day of the month). The difference between the market value and net book value is the unrealized gain or (loss). The Detail Transaction Report Section is provided in compliance with California Government Code Section 53607, which requires that the Treasurer file such a report with the Board of Supervisors, from whom his investment authority has been delegated.

Conclusion

I am thankful for the opportunity to serve our community in this capacity. It has been an honor to assist in the continuing process of renewing Orange County's financial standing in the municipal community. I am grateful to my staff for the extraordinary efforts they have provided in making this department such a professional one. Your encouragement and continued assistance have helped to make it so.

Very truly yours,

John M. W. Moorlach, C.P.A., CFP
Orange County Treasurer-Tax Collector

JMWM:jmwm

Inventories

1/31/95 - 4/30/02

Monthly



Exhibit: 1

Capital Spending

7/ 9/82 - 5/31/02

Monthly



Exhibit: 2

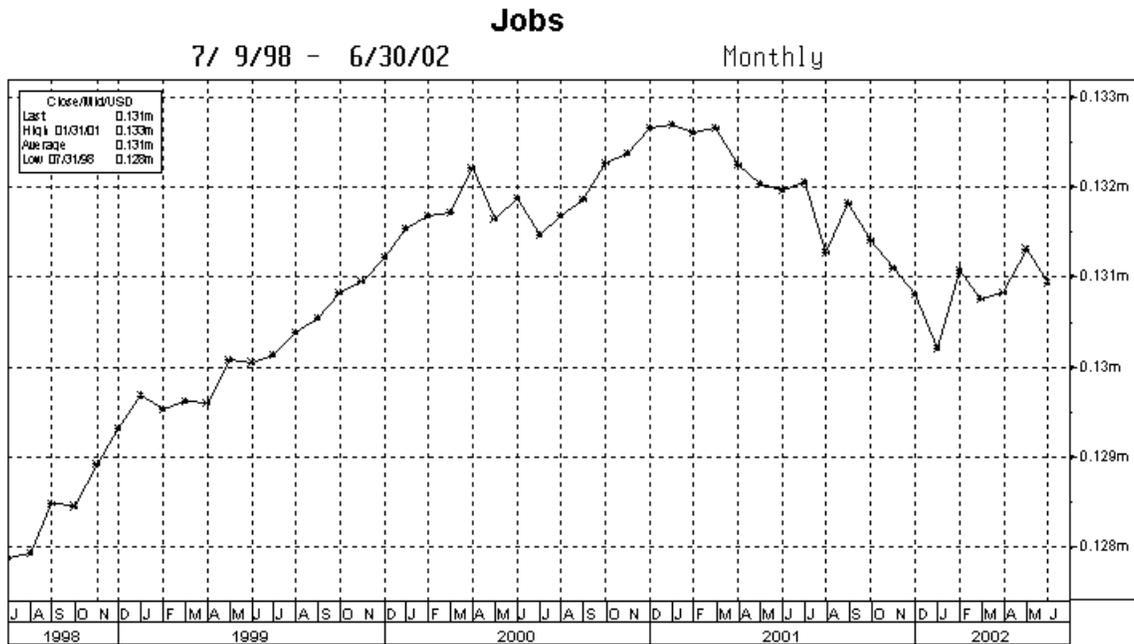


Exhibit: 3

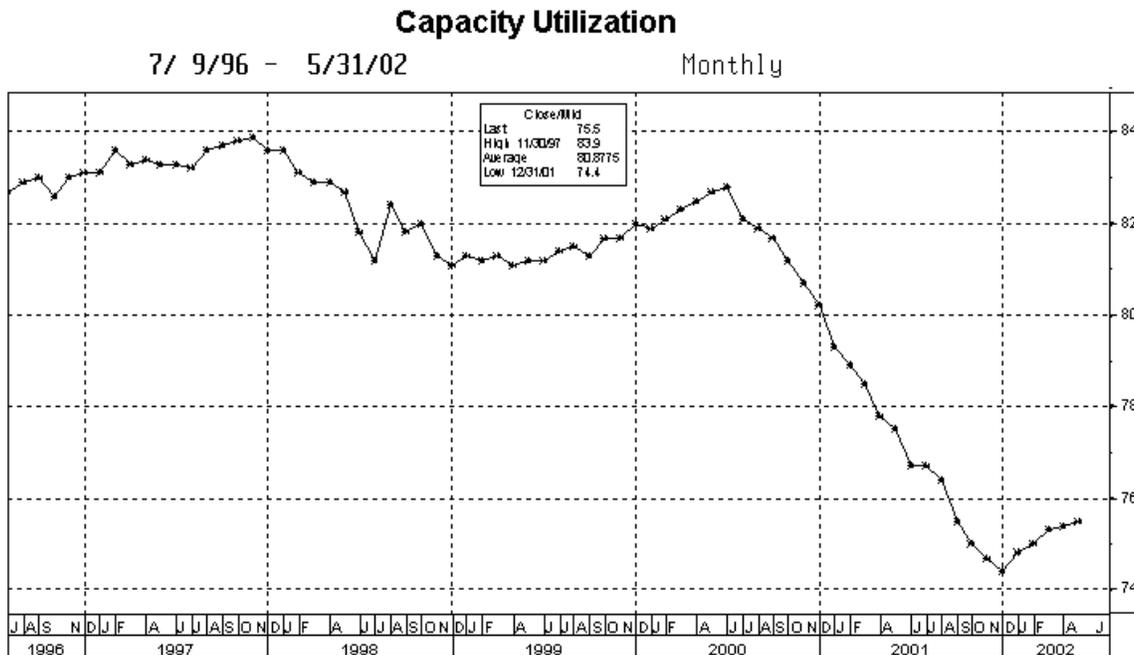


Exhibit: 4