

**FIRST 5**  
**Santa Clara County**  
**(A Component Unit of the County of Santa Clara, California)**

**INDEPENDENT AUDITORS' REPORTS, MANAGEMENT'S DISCUSSION AND ANALYSIS,  
BASIC FINANCIAL STATEMENTS, AND REQUIRED SUPPLEMENTARY INFORMATION**

**For the Fiscal Years Ended June 30, 2007 and 2006**

**FIRST 5**  
**Santa Clara County**  
**(A Component Unit of the County of Santa Clara, California)**

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*Building your future*

## INDEPENDENT AUDITORS' REPORT

To FIRST 5 Santa Clara County  
San Jose, California

We have audited the accompanying financial statements of FIRST 5 Santa Clara County (Commission), a component unit of the County of Santa Clara, California, as of and for the years ended June 30, 2007 and 2006, which collectively comprise the commission's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of June 30, 2007 and 2006, and the respective changes in financial position thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a report dated October 10, 2007, on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Member of The Leading Edge Alliance

The Management's Discussion and Analysis on pages 3 through 7 and the Schedule of Statement of Activities - Budget and Actual on page 24 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

BURR, PILGER & MAYER LLP

*Burr, Pilger & Mayer LLP*

San Jose, California

October 10, 2007

**FIRST 5  
SANTA CLARA COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2007**

FIRST 5 Santa Clara County was formed when voters approved Proposition 10 in November 1998, adding an additional excise tax on cigarettes and tobacco related products to fund programs that promote, support and improve early childhood development, for children prenatal through five years of age and their families. Proposition 10 was designed to address the lack of public funding and support for early childhood development in the wake of a growing body of scientific evidence indicating that the emotional, physical, and intellectual environment that a child is exposed to prior to five years of age has a profound impact on how his/her brain develops. The goal is for all young children in California to reach age five physically healthy and to enter school ready to learn.

In March 1999 the Santa Clara County (County) Board of Supervisors created the nine-member FIRST 5 Santa Clara County (FIRST 5) Commission. FIRST 5 is a public entity legally separate and apart from the County, and is considered a component unit of the County due to the operational relationship between FIRST 5 and the County.

Our Community Investment Strategy is based on extensive research and Community feedback, which resulted in the commission developing a clear strategy for making sound funding decisions for the programs and services offered at FIRST 5. The funding strategy is consistent with the Vision, Mission and Goals of the Organization and meets the FIRST 5 California mandate for serving all children prenatal through age 5. The programs and services offered by FIRST 5 Santa Clara County are grounded in research and evidenced based practices. The Commission adopted two funding strategies under which all investments were aligned:

Community Engagement and Education (Countywide)  
High Risk (Targeted Impact)

These Primary strategies provide for continued funding of countywide programs designed to serve all children in the County, prenatal through age 5 and target impact programs that focus on children and families in specific communities and/or regions of the County. These strategies allow FIRST 5 to direct resources to reach children prenatal through age 5 throughout Santa Clara County, while demonstrating improved outcomes of children with high cumulative risk factors in targeted communities with the largest number of children prenatal through age 5. FIRST 5 Santa Clara County is committed to ensuring that effective programs and services to young children and their families are in place and sustainable.

As management of FIRST 5, we offer readers of our FIRST 5 financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2007.

**FIRST 5  
SANTA CLARA COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2007**

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to FIRST 5's basic financial statements. FIRST 5's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-wide Financial Statements**

The government-wide financial statements are designed to provide readers with a broad overview of FIRST 5's finances, in a manner similar to private sector business.

The Statement of Net Assets presents information on all of FIRST 5's assets and liabilities, with the difference between the two reported as net assets.

The Statement of Activities presents information showing how FIRST 5's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods (e.g. earned but unused vacation leave). The government-wide financial statements can be found on pages 8 and 9 of this report.

**Fund Financial Statements**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Fund financial statements report essentially the same functions as those reported in the government-wide financial statements. However, unlike the government-wide financial statements, fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year.

Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate the comparison between governmental funds and government-wide statements. The fund financial statements can be found on pages 10 and 11 of this report.

**Notes to Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 12-23 of this report.

**FIRST 5  
SANTA CLARA COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2007

**Government-wide Financial Analysis**

FIRST 5 uses government-wide financial reporting to provide a broad overview in a manner similar to the private sector. In most cases, net assets may serve over time as a useful indicator of a government's financial position. In the case of FIRST 5, assets exceeded liabilities by \$95.6 million at the close of the most recent fiscal year. The most significant portion of FIRST 5's current assets of \$96.8 million is its cash and investments balance of \$92.5 million. This represents resources received from the State Commission from Proposition 10 taxes that have not been expended. The majority of cash and investments are maintained by Merrill Lynch where interest earned is reinvested. The balance of cash is maintained in the County's cash and investment commingled pool where interest earned on FIRST 5's balance is apportioned to FIRST 5. Another source of current assets resides in FIRST 5's receivables due from the State Commission for Proposition 10 tax revenue. These receivables of \$3.6 million represent taxes remitted by the State but not received by FIRST 5 as of June 30, 2007.

FIRST 5 also reports total liabilities of \$7.5 million of which accounts payable represents \$7.1 million, primarily representing payments due on grant service contracts that had not been disbursed at year-end.

FIRST 5 net assets of \$95.6 million decreased by \$0.2 million or 0.2% from the prior fiscal year.

**Condensed Statement of Net Assets**

	<u>FY 2006/2007</u>	<u>FY 2005/2006</u>	<u>% Change</u>
Assets:			
Current and Other Assets	\$ 96,833,518	\$ 95,166,828	1.8%
Capital Assets	6,268,241	6,499,445	-3.6%
Total Assets	<u>103,101,759</u>	<u>101,666,273</u>	1.4%
Total Liabilities	7,523,889	5,837,350	28.9%
Net Assets:			
Invested in Capital Assets	6,268,241	6,499,445	-3.6%
Restricted	<u>89,309,629</u>	<u>89,329,478</u>	0.0%
Total Net Assets	<u>\$ 95,577,870</u>	<u>\$ 95,828,923</u>	0.2%

**FIRST 5  
SANTA CLARA COUNTY**

MANAGEMENT'S DISCUSSION AND ANALYSIS  
**June 30, 2007**  
**Condensed Statement of Activities**

	<u>FY 2006/2007</u>	<u>FY 2005/2006</u>
Total Revenue	\$ 31,365,407	\$ 28,009,348
Expenses:		
Salaries, Supplies and Service	6,305,531	6,745,049
Grant Expenses	<u>25,310,929</u>	<u>23,571,956</u>
Total Expenses	31,616,460	30,317,005
Change in Net Assets	<u>\$ (251,053)</u>	<u>\$ (2,307,657)</u>

Total revenue consisting of Proposition 10 funds, interest, rental and investment income, State Commission matching and Foundation grants increased from \$28.0 million to \$31.4 million for the year ended June 30, 2007. This increase was primarily due to an increase in the State Commission matching grants and the interest and investment income.

Total expenditures decreased to \$6.3 million, a decrease of \$0.4 million from the prior year. This decrease is primarily due to lower operating expenses.

For the fiscal year ended June 30, 2007, FIRST 5 reported a change in net assets of \$0.3 million from the prior year. This decrease represents the amount of expenditures in excess of revenues for the period ended June 30, 2007.

**Governmental Activities**

FIRST 5 does not have business type activities and so the analysis presented above for the government-wide financial statements also represents an analysis of FIRST 5's governmental activities.

**Financial Analysis of FIRST 5's Governmental Fund**

For fiscal year ended June 30, 2007, FIRST 5 reported an ending fund balance of \$89.5 million, same as prior year. FIRST 5 has committed 100% of the \$89.5 million as shown below:

**FIRST 5  
SANTA CLARA COUNTY**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
June 30, 2007**

**Committed Funds  
Fiscal Year 2006/2007**

Reserved for Encumbrances	\$ 1,345,196
Reserved for Obligation	32,217,292
Funds Invested in Capital Assets	6,268,241
Reserved for First 5 California Initiatives	6,400,000
Program Sustainability	32,486,607
Designated for Local Initiatives	10,771,772
Total Committed Funds	<u>\$ 89,489,108</u>

In broad terms, “committed funds” represent the portion of the fund balance that have been set aside for programs, projects, and activities to be conducted in the future according to our Community Investment Strategy & Budget formally approved by our FIRST 5 County Commission. As a result these funds are unavailable for uses other than the purposes for which they were designated.

**Budgetary Highlights**

Total expenditures were \$7.1 million less than budget due to the delay in start-up time for funded programs and initiatives that were awarded in fiscal year ended June 30, 2007.

**Capital Assets and Debt Administration**

**Capital Assets**

FIRST 5’s capital assets for its governmental activities as of June 30, 2007, amounted to \$6.3 million (net of accumulated depreciation). Capital assets include our building, furniture and equipment. See Note 3 to the Notes to the Financial Statements for a more detailed analysis of changes in capital assets.

**Debt Administration** At the end of the current fiscal year, FIRST 5 did not have any long-term obligations outstanding.

**Requests for Information**

This financial report is designed to provide a general overview of FIRST 5 Santa Clara County’s finances for all those interested. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to FIRST 5 Santa Clara County, 4000 Moorpark Ave., Suite 200, San Jose, California 95117.

**FIRST 5**  
**SANTA CLARA COUNTY**  
**STATEMENT OF NET ASSETS**  
June 30, 2007 and 2006

ASSETS

	2007	2006
Cash and investments	\$ 92,528,917	\$ 89,855,118
Interest receivable	539,966	398,860
Grant and other receivable	111,758	50,965
Due from the State - Proposition 10	3,642,778	4,827,153
Prepays and other assets	10,099	34,732
Capital assets, net of depreciation	6,268,241	6,499,445
Total assets	\$ 103,101,759	\$ 101,666,273

LIABILITIES AND NET ASSETS

Accounts payable	\$ 7,060,736	\$ 5,362,682
Accrued salaries and benefits	205,652	201,069
Accrued vacation payable	179,479	177,991
Other accrued liabilities	78,022	95,608
Total liabilities	7,523,889	5,837,350
Net Assets:		
Invested in capital assets	6,268,241	6,499,445
Restricted	89,309,629	89,329,478
Total net assets	\$ 95,577,870	\$ 95,828,923

See accompanying notes to basic financial statements.

**FIRST 5**  
**SANTA CLARA COUNTY**  
**STATEMENT OF ACTIVITIES**  
For the Years Ended June 30, 2007 and 2006

	2007	2006
FIRST 5 Program Expenses:		
Salaries and benefits	\$ 4,056,085	\$ 4,498,434
Supplies and services	2,018,242	2,019,811
Grant expenditures	25,310,929	23,571,956
Depreciation	231,204	226,804
Total Program Expenses	31,616,460	30,317,005
Program Revenue:		
Operating grants and contributions		
Proposition 10 taxes	22,000,091	23,406,400
Foundation and state matching grants	3,931,474	2,091,587
Total Program Revenues	25,931,565	25,497,987
Net Program Revenue (Expenses)	(5,684,895)	(4,819,018)
General Revenue		
Investment income	4,765,031	2,197,111
Rental income	146,445	86,585
Other income	522,366	227,665
Total General Revenue	5,433,842	2,511,361
Change in net assets	(251,053)	(2,307,657)
Net assets, beginning of year	95,828,923	98,136,580
Net assets, end of year	\$ 95,577,870	\$ 95,828,923

See accompanying notes to basic financial statements.

**FIRST 5**  
**SANTA CLARA COUNTY**  
**BALANCE SHEET - GOVERNMENTAL FUND**  
June 30, 2007 and 2006

	ASSETS	
	2007	2006
Cash and investments	\$ 92,528,917	\$ 89,855,118
Interest receivable	539,966	398,860
Grant and other receivable	111,758	50,965
Due from the State - Proposition 10	3,642,778	4,827,153
Prepays and other assets	10,099	34,732
Total assets	\$ 96,833,518	\$ 95,166,828

LIABILITIES AND FUND BALANCE		
Liabilities:		
Accounts payable	\$ 7,060,736	\$ 5,362,682
Accrued salaries and benefits	205,652	201,069
Other accrued liabilities	78,022	95,608
Total liabilities	7,344,410	5,659,359
Fund Balance:		
Reserved for encumbrances	1,345,196	1,216,904
Unreserved:		
Designated for School Readiness, Regional Partnership and Other Programs	55,657,305	40,737,739
Undesignated	32,486,607	47,552,826
Total fund balance	89,489,108	89,507,469
Total liabilities and fund balance	\$ 96,833,518	\$ 95,166,828

RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL  
FUND TO THE STATEMENT OF NET ASSETS

Fund balance - from above	\$ 89,489,108	\$ 89,507,469
Amount reported in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	6,268,241	6,499,445
Accrued vacation payable is not due and payable with current financial resources and is not reported in the governmental funds.	(179,479)	(177,991)
Net Assets	\$ 95,577,870	\$ 95,828,923

See accompanying notes to basic financial statements.

**FIRST 5**  
**SANTA CLARA COUNTY**  
STATEMENT OF REVENUES, EXPENDITURES AND  
CHANGES IN FUND BALANCE - GOVERNMENTAL FUND  
For the Years Ended June 30, 2007 and 2006

	2007	2006
Revenues:		
Proposition 10 taxes	\$ 22,000,091	\$ 23,406,400
Foundation and state matching grants	3,931,474	2,091,587
Investment income	4,765,031	2,197,111
Rental income	146,445	86,585
Other revenue	522,366	227,665
	31,365,407	28,009,348
Expenditures:		
Current:		
Salaries and benefits	4,054,597	4,473,285
Supplies and services	2,018,242	2,019,811
Grant expenditures	25,310,929	23,571,956
Capital outlay	-	5,029,849
	31,383,768	35,094,901
Change in fund balance	(18,361)	(7,085,553)
Fund balance, beginning of year	89,507,469	96,593,022
Fund balance, end of year	\$ 89,489,108	\$ 89,507,469

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGE IN FUND BALANCE - GOVERNMENTAL FUND TO THE  
STATEMENT OF ACTIVITIES

Net change in fund balance - from above	\$ (18,361)	\$ (7,085,553)
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Amount reported in the Statement of Activities  
are different because:

Governmental funds report capital outlay as expenditures.

However, in the Statement of Activities, the cost of  
those assets is allocated over their estimated useful  
lives and reported as depreciation expense.

Expenditures for general capital assets	-	5,029,849
Less current year depreciation	(231,204)	(226,804)

The change in accrued vacation payable reported  
in the Statement of Activities does not require  
the use of current financial resources and  
therefore is not reported as expenditures in  
governmental funds.

	(1,488)	(25,149)
Change in Net Assets	\$ (251,053)	\$ (2,307,657)

See accompanying notes to basic financial statements.

FIRST 5  
SANTA CLARA COUNTY

NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity**

The Santa Clara County Board of Supervisors created the Commission on March 30, 1999, under the provisions of the Act. The Act became law in 1998 when California (State) voters approved Proposition 10, authorizing the State to levy a tax on tobacco products to pay for programs to promote the healthy development of young children. The Commission is a public entity legally separate and apart from the County. The purpose of the Commission is to develop, adopt, promote and implement early childhood development programs in the County consistent with the goals and objectives of the Act. The Commission's programs are funded by the taxes imposed by Proposition 10.

The Commission consists of nine members appointed by the County Board of Supervisors. The Commission is considered a component unit of the County due to the operational relationship between the Commission and the County; therefore, the Commission's financial statements are included in the County's Comprehensive Annual Financial Report.

**Governmental Accounting Standards Board Statements and Interpretation**

The financial statements are prepared in accordance with GASB Statement No. 34. This statement affects the manner in which the Commission records transactions and presents financial information.

*Management's Discussion and Analysis*

GASB Statement No. 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the Commission's financial activities in the form of "management's discussion and analysis" (MD&A). This analysis is similar to the analysis provided in the annual reports of private-sector organizations.

*Government-wide Financial Statements*

The reporting model includes financial statements prepared using full accrual accounting for all of the Commission's activities. This approach includes not just current assets and liabilities but also capital and other long-term assets as well as long-term liabilities. Accrual accounting also reports all of the revenues and costs of providing services each year, not just those received or paid in the current year or soon thereafter.

*Statement of Net Assets*

The Statement of Net Assets is designed to display the financial position of the government. The net assets of the Commission are broken down into two categories - invested in capital assets and restricted.

FIRST 5  
SANTA CLARA COUNTY

NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Government-wide Financial Statements (Continued)*

*Statement of Activities* - The Statement of Activities reports expenses and revenues in a format that focuses on the cost of the Commission's function. The expense of individual functions is compared to the revenue generated directly by the function.

Accordingly, the Commission has recorded certain other long-term assets and liabilities in the Statement of Net Assets, and has reported all revenues and the cost of providing services under the accrual basis of accounting in the Statement of Activities.

**Statement No. 38.** The Commission adopted the provisions of GASB Statement No. 38, "Certain Financial Statement Note Disclosures." This statement modifies, establishes and rescinds certain financial statement disclosure requirements. Accordingly, certain footnote disclosures have been revised to conform to the provisions of GASB Statement No. 38.

**Interpretation No. 6.** The Commission adopted the provisions of GASB Interpretation No. 6, "Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements." This interpretation clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice. This interpretation impacts the fund level financial statements required by GASB Statement No. 34 but has no direct impact on the government-wide financial statements.

Basis of Presentation and Accounting

*Government-wide Financial Statements*

The Statement of Net Assets and Statement of Activities display information about the primary government (Commission). These statements include the financial activities of the overall government.

The Statement of Activities presents a comparison between direct expenses and program revenues for the Commission's governmental activity. Direct expenses are those that are specifically associated with the Commission. Program revenues include grants and contributions that are restricted to meeting the operational or capital requirements of the Commission. Revenues that are not classified as program revenues, including investment income, are presented instead as general revenues.

FIRST 5  
SANTA CLARA COUNTY

NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Government-wide Financial Statements (Continued)*

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Nonexchange transactions, in which the Commission gives (or receives) value without directly receiving (or giving) equal value in exchange, include Proposition 10 taxes, grants, entitlements and donations. Revenues from Proposition 10 taxes are recognized when all eligibility requirements are met which coincides with the State apportions Proposition 10 tax revenues to the Commission. Revenues from grants, entitlements and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

Separate financial statements are provided for the governmental fund. The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting.

Under this method, revenues are recognized when measurable and available to finance expenditures of the current period. Proposition 10 apportionments, grant revenues and investment income are accrued when their receipt occurs within ninety days after the end of the accounting period so as to be both measurable and available. All receivables are expected to be collected within the current year. Expenditures are generally recorded when a liability is incurred, under the accrual basis of accounting. In the current year, the bulk of the accounts payable balance (approximately 90% and 94% at June 30, 2007 and 2006, respectively) relates to payables owed to contractors used in the operation of the Commission's programs. The balance relates to miscellaneous accounts payable. General capital assets acquisitions are reported as expenditures in the governmental fund.

**Non-current Governmental Assets/Liabilities**

GASB Statement No. 34 eliminates the presentation of account groups, but provides for these records to be maintained and incorporates the information into the Government-wide Statement of Net Assets.

**Accounts Receivable**

Significant receivables included amounts due from the State of California for Proposition 10 taxes and the County of Santa Clara for earnings on commission funds held in the County's commingled pool. These receivables are due within one year.

The Commission utilizes the allowance method for recognizing bad debts. Management has determined that no allowance for bad debt is required.

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Capital Assets**

This includes furniture and equipment, building and building improvements that are reported as governmental activity in the Statement of Net Assets. Capital assets are defined as assets with an initial individual cost of \$5,000 or more and an estimated useful life in excess of one year. Donated capital assets are recorded at estimated fair market value at the date of donation. Furniture and equipment, building and building improvements are depreciated using the straight-line method over the following estimated useful lives:

Furniture and equipment	5 years
Building	20 years
Building improvements	20 years

**Accrued Vacation and Sick Leave Pay**

Vacation pay, which may be accumulated up to six weeks, depending on the employee's length of service, is payable upon termination.

Sick leave accrues at approximately 3 hours per pay period and is not limited by how much may be accumulated. Sick leave earned is non-vesting and employees are not reimbursed for accumulated sick leave upon termination.

The Commission accrues for all salary-related items in the government-wide financial statements for which they are liable to make a payment directly and incrementally associated with payments made for compensated absences on termination. The Commission includes its share of Social Security and Medicare payments made on behalf of the employees in its accrual for vacation.

**Foundation Grants**

Foundation grants include funds received from 501(c)(3) not-for-profit and community based organizations to promote the Commission's stated objectives.

**Estimates**

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**FIRST 5  
SANTA CLARA COUNTY**

NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Budget and Budgetary Reporting**

The Commission is required to prepare a budget each year based on estimates of revenues and expected expenditures. The budget is adopted on a basis consistent with GAAP. Budgetary control is exercised at the major object level. All changes to the budget during the year require the approval of the Commission. All unencumbered annual appropriations lapse at the end of each fiscal year.

**Reservations of Fund Balance**

Reservations of fund balance of the governmental fund indicate that portion of fund equity which is not available for appropriation for expenditure or is legally segregated for a specific future use. Following is a description of the nature of certain reserves.

*Reserve for Encumbrances* - A reserve is set aside for certain contractual obligations that the Commission has with its sub-recipients in the operation of programmatic activities. These obligations in the current year do not constitute expenditures or liabilities, but once the sub-recipient fulfills certain eligibility requirements, will represent expenditures or liabilities.

**2. CASH AND INVESTMENTS**

The Commission had the following cash and investments at June 30:

	2007	2006
Cash:		
Commercial Banks	\$ 46,936	\$ 3,040,687
County Commingled Pool	38,824,734	35,685,840
	38,871,670	38,726,527
Investments:		
U.S. Treasuries	\$ 12,760,731	\$ 13,067,266
U.S. Agencies	25,075,629	22,448,422
Corporate Bonds	14,187,040	14,782,550
Money Funds	1,047,936	339,694
Accrued Interest	585,911	490,659
	53,657,247	51,128,591
Total Cash and Investments	\$ 92,528,917	\$ 89,855,118

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**2. CASH AND INVESTMENTS, Continued**

At June 30, 2007 and 2006, cash and investments of \$38,824,734 and \$35,685,840 are held in the County's commingled pool, which is managed by the County Treasurer. The difference between cash held in the County Treasury and cash recorded on the Commission's books as being held by the County Treasurer is reflective of checks outstanding that have been recorded on the Commission's books, but not recorded by the County. The County's Treasury Oversight Committee is responsible for the regulatory oversight of the commingled pool. The County reports all of its investments, including the investments of its commingled pool, at fair value. The County Treasurer determines the fair value of the pool on a monthly basis, based on quoted market prices. The value of the pooled shares that may be withdrawn is based upon amortized cost, which is different than the fair value. Realized and unrealized earnings and losses are allocated annually to commingled investment pool participants based on the participants' average daily cash balance relative to the entire pool. Information regarding the County's cash and investments, including custodial risk categories, collateral, and maturities, can be found in the Notes of the County's basic financial statements. The Commission also maintains cash in separate bank accounts. The Commission's carrying amount for its cash recorded in separate bank accounts was \$46,936 and \$3,040,688 for the years ended June 30, 2007 and 2006, respectively. The Commission maintains its cash and cash equivalents in commercial checking and money market accounts. Periodically throughout the year, cash is maintained at the various banks in excess of insured (FDIC) amounts of \$100,000.

Cash and investment income/(loss) at June 30, 2007 and 2006 is as follows:

	2007	2006
Realized gain/(loss) on matured/sold investments	\$ 22,229	\$ (89,906)
Unrealized gain/(loss) in changes in fair value of investments	543,578	(980,598)
Net gain/(loss)	565,807	(1,070,504)
Interest income	4,199,224	3,267,615
Total investment income	\$ 4,765,031	\$ 2,197,111

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**2. CASH AND INVESTMENTS, Continued**

Risk Disclosures:

Interest Rate Risk - The Commission utilizes Merrill Lynch to manage its investment portfolio of Government and Corporate bonds in accordance with the Commission's investment policy. The policy's three main objectives include: safeguarding of principal, meeting the liquidity needs of the Commission, and achieving a competitive rate of return. The Commission's policy indicates all eligible investments and requirements must comply with Government Code Section 53635.2.

As of June 30, 2007, the Commission had the following investments and maturities:

Investment Type	Fair Value	Less than 1 Year	1 - 5 Years
U.S. Treasuries	\$ 12,760,731	\$ -	\$ 12,760,731
U.S. Agencies	25,075,629	-	25,075,629
Corporate Bonds	14,187,040	1,739,045	12,447,995
Money Funds	1,047,936	1,047,936	-
Accrued Interest	585,911	585,911	-
	<u>\$ 53,657,247</u>	<u>\$ 3,372,892</u>	<u>\$ 50,284,355</u>

As of June 30, 2006, the Commission had the following investments and maturities:

Investment Type	Fair Value	Less than 1 Year	1 - 5 Years
U.S. Treasuries	\$ 13,067,266	\$ 3,225,105	\$ 9,842,161
U.S. Agencies	22,448,422	6,501,288	15,947,134
Corporate Bonds	14,782,550	4,989,907	9,792,643
Money Funds	339,694	339,694	-
Accrued Interest	490,659	490,659	-
	<u>\$ 51,128,591</u>	<u>\$ 15,546,653</u>	<u>\$ 35,581,938</u>

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**2. CASH AND INVESTMENTS, Continued**

Risk Disclosures (Continued):

Credit Risk - State law limits investments in commercial paper and corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSRO's). At June 30, 2007, the Commission's credit risks, expressed on a percentage basis, are as follows:

Investment Type	Credit Quality Rating		Fair Value at	% of
	Moody	S&P	June 30, 2007	Investment
<i>U.S. Treasury:</i>				
U.S. Treasury Notes	AAA	AAA	\$ 12,760,731	23.8%
<i>U.S. Agency Bond</i>				
Federal Home Loan Mortgage Corporation (FHLMC)	AAA	AAA	6,511,633	12.1%
Federal Home Loan Bank	AAA	AAA	6,352,743	11.8%
Federal National Mortgage Association (FNMA)	AAA	AAA	12,211,253	22.8%
<i>Corporate Bonds</i>				
CitiCC	AAA	AAA	1,232,019	2.3%
Home Depot Inc.	AA3	A+	1,699,233	3.2%
MBNA	AAA	AAA	1,214,579	2.3%
Target Corp	AA1	A+	1,777,808	3.3%
Goldman Sachs Group, Inc.	AA3	AA-	1,739,045	3.2%
Bank of America	AA1	AA	1,802,308	3.4%
CIT Group	A2	A	966,350	1.8%
Citigroup Incl.	AA1	AA	2,030,095	3.8%
General Electric Cap Cor	AAA	AAA	1,725,603	3.2%
Money Funds	Not Rated		1,047,936	2.0%
Accrued Interest	Not Rated		585,911	1.1%
			<u>\$ 53,657,247</u>	

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**3. CAPITAL ASSETS**

The following is a summary of changes in the capital assets for the year ended June 30, 2007 and 2006:

**Governmental Activities**

	Balance July 1, 2006	Additions	Retirements	Balance June 30, 2006
Furniture and Equipment	\$ 265,001	\$ -	\$ -	\$ 265,001
Building Improvements	1,264,865	-	-	1,264,865
Building	3,000,908	-	-	3,000,908
Land	2,357,856	-	-	2,357,856
Total	6,888,630	-	-	6,888,630
Less accumulated depreciation for:				
Furniture and Equipment	195,253	17,916	-	213,169
Building improvements	68,894	63,240	-	132,134
Building	125,038	150,048	-	275,086
Accumulated Depreciation	389,185	231,204	-	620,389
Total capital assets, net	<u>\$ 6,499,445</u>	<u>\$ (231,204)</u>	<u>\$ -</u>	<u>\$ 6,268,241</u>

**Governmental Activities**

	Balance July 1, 2005	Additions	Retirements	Balance June 30, 2006
Furniture and Equipment	\$ 457,731	\$ -	\$ (192,730)	\$ 265,001
Building Improvements	1,401,050	175,214	(311,399)	1,264,865
Building	-	3,000,908	-	3,000,908
Land	-	2,357,856	-	2,357,856
Total	1,858,781	5,533,978	(504,129)	6,888,630
Less accumulated depreciation for:				
Furniture and Equipment	156,162	39,091	-	195,253
Building improvements	6,219	62,675	-	68,894
Building	-	125,038	-	125,038
Accumulated Depreciation	162,381	226,804	-	389,185
Total capital assets, net	<u>\$ 1,696,400</u>	<u>\$ 5,307,174</u>	<u>\$ (504,129)</u>	<u>\$ 6,499,445</u>

Depreciation is allocated in total to the Commission's program expense.

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**4. POST EMPLOYMENT BENEFITS**

**Pension Plans - Description**

In November 2001, the Commission's board approved the implementation of an Internal Revenue Code Section 401(a) retirement plan (the Plan) effective January 1, 2002 for all Commission employees. The Plan is a defined contribution plan administered by the Unified Trust Company. The Plan is open to all employees, excluding temporary employees who work less than 20 hours per week. Currently, 46 employees are enrolled in the Plan. The Plan provides retirement benefits based on the employee's salary and years of service.

The Plan requires employer contributions of 7% of employees' annual salaries and wages. Employees vest 100% after three years of employment service. Employer contributions were \$192,103 and \$193,806 for the years ended June 30, 2007 and 2006, respectively. The contribution requirements of Plan members and the Commission are established by and may be amended by the Unified Trust Company.

**Deferred Compensation Plan**

The Commission also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 (457 Plan). The 457 Plan, available to all employees excluding part-time employees who work less than 20 hours a week, permits them to defer a portion of their salary until future years. The Commission contributes a dollar for dollar match on the elective deferrals to a maximum of 5% of each employee's annual compensation. The Commission's contributions were \$108,974 and \$136,376 for the years ended June 30, 2007 and 2006, respectively. The 457 Plan is administered by the Unified Trust Company. The Commission has no administrative involvement and does not perform the investing function. The Commission remits deferred compensation plan contributions to the 457 Plan Administrator every pay period.

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**5. OPERATING LEASES**

The Commission leases equipment under non-cancelable operating leases with terms of thirty-six months. Future minimum rental payments under operating leases with initial or remaining non-cancelable lease terms are as follows:

Year Ending <u>June 30,</u>	
2008	<u>\$ 3,113</u>

Rental expenditures for the year ended June 30, 2007 and 2006 totaled \$15,448 and \$104,779, respectively.

The Commission leases a portion of its San Jose facility to third parties under non-cancelable lease agreements which extend into the future. Minimum lease payments to be received as of June 30, 2007 for each of the next five years are as follows:

Year Ending <u>June 30,</u>	
2008	\$ 106,774
2009	65,574
2010	17,233
2011	<u>12,864</u>
	<u>\$ 202,445</u>

Total rental income for the year ended June 30, 2007 and 2006 totaled \$146,445 and \$86,585, respectively.

**6. RISK MANAGEMENT**

The Commission is exposed to various risks of loss related to torts; theft of, or damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; unemployment; and health benefits to employees. The Commission has purchased insurance to cover general liability up to \$5 million, criminal bond up to \$10 million, workers compensation up to \$5 million, property insurance up to \$25 million, auto liability up to \$1 million and employment practice up to \$2 million.

**FIRST 5  
SANTA CLARA COUNTY**

**NOTES TO BASIC FINANCIAL STATEMENTS  
For the Years Ended June 30, 2007 and 2006**

**7. GRANT ENCUMBRANCES**

At June 30, 2007 and 2006, the Commission's remaining commitment with grantees was as follows:

	Remaining Commitment at <u>June 30, 2007</u>	Remaining Commitment at <u>June 30, 2006</u>
Projects		
Early Childhood Institute	\$ 1,345,196	\$ 1,108,076
Miscellaneous Grants	-	108,828
Total	<u>\$ 1,345,196</u>	<u>\$ 1,216,904</u>

**8. PROGRAM EVALUATION**

The Commission spent approximately \$813,500 on program evaluation during the audit period.

**FIRST 5**  
**SANTA CLARA COUNTY**  
**SCHEDULE OF STATEMENT OF ACTIVITIES**  
**BUDGET AND ACTUAL**  
For the Year Ended June 30, 2007

	Original Budget	Final Budget	Actual Amount	Variance with Final Budget Positive (Negative)
<b>Revenues</b>				
Proposition 10 taxes	\$ 21,885,900	\$ 21,885,900	\$ 22,000,091	\$ 114,191
Foundation and state matching grants	3,620,300	3,620,300	3,931,474	311,174
Investment income	2,617,800	2,617,800	4,765,031	2,147,231
Other revenue	302,000	342,000	668,811	326,811
<b>Total revenues</b>	<u>28,426,000</u>	<u>28,466,000</u>	<u>31,365,407</u>	<u>2,899,407</u>
<b>Expenditures</b>				
<b>Current:</b>				
Salaries and benefits	4,665,200	4,750,500	4,056,085	(694,415)
Supplies and services	2,534,800	2,561,300	2,249,446	(311,854)
Grant expenditures	31,375,000	31,375,000	25,310,929	(6,064,071)
<b>Total expenses</b>	<u>38,575,000</u>	<u>38,686,800</u>	<u>31,616,460</u>	<u>(7,070,340)</u>
Change in net assets	<u>\$ (10,149,000)</u>	<u>\$ (10,220,800)</u>	(251,053)	<u>\$ 9,969,747</u>
Net assets, beginning of year			<u>95,828,923</u>	
Net assets, end of year			<u>\$ 95,577,870</u>	

- 1) The above budgetary information was prepared using the same methodologies as the preparation of the government wide financial statements which include a provision for depreciation and accrued vacation expense.
- 2) Total actual expenditures in the current year were less than budget due to a reduction in the grant expenditure category. This reduction was due to total encumbered and committed grant amounts not fully realized during the contract term.

See accompanying notes to basic financial statements.

## SUPPLEMENTARY INFORMATION



*Building your future*

INDEPENDENT AUDITORS' REPORT  
ON SUPPLEMENTAL INFORMATION

To FIRST 5 Santa Clara County  
San Jose, California

Our report on our audit of the basic financial statements of FIRST 5 Santa Clara County for year ended June 30, 2007 is on page 1. That audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule of Governmental Fund Balance and Statement of Revenues & Expenditures for the year ended June 30, 2007 is presented for purposes of additional analysis and is not a required part of the basic financial statements; however, are required by the California Children & Families Commission. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

BURR, PILGER & MAYER LLP

*Burr, Pilger & Mayer LLP*

San Jose, California  
October 10, 2007

*Member of The Leading Edge Alliance*

**FIRST 5**  
**SANTA CLARA COUNTY**  
**SCHEDULE OF GOVERNMENTAL FUND BALANCE**  
For the Year Ended June 30, 2007

Total Fund Balance	\$	89,489,108
Committed Funds		
Reserved for Encumbrances	\$	1,345,196
Reserved for Obligations		32,217,292
Funds Invested in Capital Assets		6,268,241
Reserved for First 5 California Initiatives		6,400,000
Program Sustainability		32,486,607
Designated for Local Initiatives		<u>10,771,772</u>
Total Committed Funds	\$	<u>89,489,108</u>
Uncommitted Funds	\$	<u><u>-</u></u>

See accompanying notes to supplemental schedule.

**FIRST 5  
SANTA CLARA COUNTY**

NOTES TO SCHEDULE OF GOVERNMENTAL FUND BALANCE  
For the Year Ended June 30, 2007

**Basis of Presentation**

Reservations of fund balance of the governmental fund indicate that portion of fund equity which is not available for appropriation for expenditure or is legally segregated for a specific future use. Following is a description of the nature of certain reserves.

*Reserve for Encumbrances* - A reserve is set aside for certain contractual obligations that the Commission has with its sub-recipients in the operation of programmatic activities. These obligations in the current year do not constitute expenditures or liabilities, but once the sub-recipient fulfills certain eligibility requirements, will represent expenditures or liabilities.

*Reserve for Obligations* - A reserve is established for situations where the Commission has explicitly authorized and directed staff to enter into an agreement with a specified agency, but the contract has not actually been executed.

*Funds invested in Capital Assets* - A reserve is established for net capital assets purchased by the Commission.

*Reserve for FIRST 5 California Initiatives* - A reserve is established for the total future amounts the Commission will receive as part of a guaranteed county matching program.

*Designated for Local Initiatives and Program Sustainability* - A reserve has been established for specific programs or projects in the current or future fiscal years which meet certain criteria and funds which are to be used for the long term sustainability of the programs.

**FIRST 5**  
**SANTA CLARA COUNTY**  
**STATEMENT OF REVENUES AND EXPENDITURES**  
For the Year Ended June 30, 2007

	School Readiness	Retention Incentives
Revenue	\$ 1,605,183	\$ 1,655,652
Expenses	1,800,000	1,004,832
	\$ (194,817)	\$ 650,820

Basis of Presentation:

The accompanying Schedule of Revenues and Expenditures presents funds received and expensed for Retention Incentives and School Readiness programs. This presentation is a required schedule in accordance with fiscal audit guidelines issued by the state of California Children's and Families Commission. Under this presentation, revenues are recognized when all eligibility requirements are met which coincides with State apportions and revenues to the Commission and expenses are recorded when incurred.

See accompanying notes to supplemental schedule.



*Building your future*

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED  
ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

To FIRST 5 Santa Clara County  
San Jose, California

We have audited the accompanying financial statements of FIRST 5 Santa Clara County (Commission), as of and for the year ended June 30, 2007 and have issued our report thereon dated October 10, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

*Internal Control over Financial Reporting*

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financing reporting that might be a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

*Compliance and Other Matters*

As part of obtaining reasonable assurance about whether the financial statements of the Commission are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

*Member of The Leading Edge Alliance*

This report is intended solely for the information and use of the County Board of Supervisors, FIRST 5 Santa Clara County, the State Commission and the State Controller's Office and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

BURR, PILGER & MAYER LLP

*Burr, Pilger & Mayer LLP*

San Jose, California

October 10, 2007



Building your future

INDEPENDENT AUDITORS' REPORT ON STATE COMPLIANCE

To FIRST 5 Santa Clara County
San Jose, California

We have audited the basic financial statements of the FIRST 5 Santa Clara County Children and Families Commission, a component unit of Santa Clara County, as of and for the year ended June 30, 2007 and have issued our report thereon dated October 10, 2007.

Our audit was conducted in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the State of California's Standards and Procedures for Audits of California Counties Participating in the California Children and Families Program, issued by the State Controller's Office. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Commission's management is responsible for the Commission's compliance with laws and regulations. In connection with the audit referred to above, we selected and tested transactions and records to determine the commission's compliance with the laws and regulations applicable to the following items.

Table with 3 columns: Description, Audit Guide Procedures, and Procedures Performed. Rows include Contracting and Procurement, Administrative Costs, Conflict of Interest, County Ordinance, Long-Range Financial Plans, Financial Condition of the Commission, Program Evaluation, and Salaries and Benefits Policies.

Member of The Leading Edge Alliance

Based on our audit we found that, for the items tested, the First 5 Santa Clara County Children and Families Commission complied with the laws and regulations of the items referred to above. Further, based on our examination, for items not tested, nothing came to our attention to indicate that the Commission had not complied with the laws and regulations of the California Children and Families program.

This report is intended solely for the information of the County Board of Supervisors, the County Commission, the State Commission, and the State Controller's Office and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Burr, Puzer's Mayer LLP  
San Jose, California  
October 10, 2007