

MANAGEMENT'S DISCUSSION AND ANALYSIS

To the Honorable Members of the Board of Supervisors To the Citizens of Caroline County County of Caroline, Virginia

As management of Caroline County, we offer readers of the County's financial statements this narrative overview and analysis of the financial activities of Caroline County for the fiscal year ended June 30, 2007. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal.

Financial Highlights

Government-Wide Financial Statements

- The assets of the County exceeded its liabilities at the close of the most recent fiscal year by \$10,392,612 (Total Net Assets). The County is reporting a deficit in unrestricted Net Assets of \$3,668,696.
- The County's total net assets increased by \$1,527,295, or 17%, in the fiscal year ended June 30, 2007.

Fund Financial Statements

- Total fund balance of the County's Governmental Funds, reporting on a current financial resources basis, amounted to \$14,089,226 at June 30, 2007. This was a decrease of \$10,342,472 over the prior year. The General Fund's fund balance position declined somewhat, but the most significant decrease was in the Capital Projects Fund where the proceeds of debt issued in the prior year were expended for the construction of a new elementary school and other school improvements.
- During the fiscal year ended June 30, 2007, the unreserved fund balance in the General Fund dropped by \$1,164,134 to \$6,144,482. This fund balance still represents 19.2% of total General Fund expenditures and operating transfers.
- The County's total outstanding long-term debt increased by only \$770,435 to \$63,347,436 during the fiscal year ended June 30, 2007.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Caroline County's basic financial statements. The Caroline County'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 Caroline County's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of Caroline County's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of Caroline County is improving or deteriorating.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The *Statement of Activities* presents information showing how the government'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 this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of Caroline County that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of Caroline County include general government, judicial support, public safety, sanitation, public facility maintenance, social services, education, community development, and culture and recreation. The business-type activities of Caroline County include a Water and Sewer Public Utility Fund, the Milford Sanitary District, also a public water utility, and the Dawn Wastewater System.

The government-wide financial statements include not only Caroline County itself (known as the primary government), but also a legally separate school division for which Caroline County is financially accountable. Financial information for this component unit is reported separately from the financial information presented for the primary government itself.

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. Caroline County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Caroline County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions, reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental 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. Such information can be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Caroline County maintains thirteen individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, the Capital Projects Fund, the Debt Service Fund, the Social Services Fund and the Proffers Fund, all of which are considered to be major funds. Data from the other eight governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

Caroline County adopts an annual appropriated budget for all of its governmental funds. A budgetary comparison statement has been provided as part of the basic financial statements for the General Fund and Social Services Fund to demonstrate compliance with this budget. Budgetary comparison statements for other governmental funds are also provided as Required Supplementary Information in the Financial Section of this report.

Proprietary funds. Caroline County maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. Caroline County uses enterprise funds to account for its Water and Sewer Utility, for the Milford Sanitary District, and for the new Dawn Wastewater System. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among Caroline County's various functions. Caroline County uses internal service funds to account for vehicle maintenance services. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

The Proprietary fund statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water and Sewer Utility, the Milford Sanitary District, the Dawn Wastewater System and for the Vehicle Maintenance Internal Service Fund.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support Caroline County's own programs.

Notes to the 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.

Other information. Following the basic financial statements and accompanying notes, this report also presents the combining financial statements referred to earlier in connection with nonmajor governmental funds and individual budgetary comparison statements for governmental funds except the General Fund, Social Services Fund and Proffers Fund. Combining financial statements and fund budgetary comparisons are also presented for the

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

discretely presented Caroline County School Division. The School Division does not issue a separate annual financial report.

Government-Wide Financial Analysis

As noted earlier, net assets indicate the amount by which the County's total assets exceed its short and long term obligations and is a useful indicator of the County's overall financial condition at the time of measurement. In total, the County's net assets for all governmental and business-type activities amounted to \$10,392,612 at June 30, 2007. The following table summarizes the County's Statement of Net Assets:

County of Caroline, Virginia's Net Assets
As Of June 30, 2007 and June 30, 2006

	<u>Governmental</u> <u>Activities</u>		<u>Business-type</u> <u>Activities</u>		<u>Totals</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 22,158,410	\$ 25,666,012	\$ (3,364,112)	\$ 2,909,487	\$ 18,794,298	\$ 28,575,499
Capital assets	40,808,413	29,324,977	22,272,719	17,752,634	63,081,132	47,077,611
Total assets	\$ 62,966,823	\$ 54,990,989	\$ 18,908,607	\$ 20,662,121	\$ 81,875,430	\$ 75,653,110
Current liabilities	\$ 8,421,528	\$ 3,408,312	\$ 3,016,345	\$ 802,480	\$ 11,437,873	\$ 4,210,792
Long-term liabilities outstanding	44,302,701	44,814,374	15,742,244	17,762,627	60,044,945	62,577,001
Total liabilities	\$ 52,724,229	\$ 48,222,686	\$ 18,758,589	\$ 18,565,107	\$ 71,482,818	\$ 66,787,793
Net assets:						
Invested in capital assets, net of related debt	\$ 6,625,002	\$ 4,779,287	\$ 5,729,267	\$ 10,797	\$ 12,354,269	\$ 4,790,084
Restricted	-	-	1,707,039	1,578,500	1,707,039	1,578,500
Unrestricted	3,617,592	1,989,016	(7,286,288)	507,717	(3,668,696)	2,496,733
Total net assets	\$ 10,242,594	\$ 6,768,303	\$ 150,018	\$ 2,097,014	\$ 10,392,612	\$ 8,865,317

The County is reporting a deficit in the balance of unrestricted net assets of \$3,668,696. A portion of the County's assets, \$1,707,039, are subject to external restrictions on their use. These assets are primarily cash held for the payment of debt service. Restricted cash and investments held for the construction of capital assets are offset by related long term debt liabilities in calculating the County's net assets.

The County's total balance of working capital, current and other assets minus current liabilities, decreased from \$24,364,707 at June 30, 2006 to \$7,356,425 while the County's investment in capital assets increased by \$16,003,521 and its long term liabilities increased by only \$770,435 over the same period.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

As previously indicated, the County's net assets grew \$1,527,295, as net assets of governmental activities grew by \$1,242,972 and those of business-type activities, the County's water and sewer utility operations, increased \$284,323. The following table summarizes the change in the County's net assets as shown in the Statement of Activities:

County of Caroline, Virginia's Changes in Net Assets
For the Fiscal Years Ending June 30, 2007 and June 30, 2006

	Governmental		Business-type		Totals	
	Activities		Activities			
	2007	2006	2007	2006	2007	2006
Expenses:						
General government administration	\$ 3,074,553	\$ 2,948,940	\$ -	\$ -	\$ 3,074,553	\$ 2,948,940
Judicial administration	998,181	925,247	-	-	998,181	925,247
Public safety	8,517,661	9,186,284	-	-	8,517,661	9,186,284
Public works	3,984,895	3,859,700	-	-	3,984,895	3,859,700
Health and welfare	3,765,455	3,517,067	-	-	3,765,455	3,517,067
Education	11,325,718	10,508,385	-	-	11,325,718	10,508,385
Parks, recreation, and cultural	958,698	627,846	-	-	958,698	627,846
Community development	2,139,000	1,543,534	-	-	2,139,000	1,543,534
Interest and other fiscal charges	2,015,260	1,375,847	-	-	2,015,260	1,375,847
Water and sewer utilities	-	-	2,494,383	2,440,376	2,494,383	2,440,376
Total expenses	<u>\$ 36,779,421</u>	<u>\$ 34,492,850</u>	<u>\$ 2,494,383</u>	<u>\$ 2,440,376</u>	<u>\$ 39,273,804</u>	<u>\$ 36,933,226</u>
Less: Program revenues:						
Charges for services	\$ 2,126,720	\$ 2,653,403	\$ 1,036,029	\$ 842,033	\$ 3,162,749	\$ 3,495,436
Operating grants and contributions	5,336,087	4,984,176	-	-	5,336,087	4,984,176
Capital grants and contributions	1,646,016	943,695	1,532,671	1,608,986	3,178,687	2,552,681
Total program revenues	<u>\$ 9,108,823</u>	<u>\$ 8,581,274</u>	<u>\$ 2,568,700</u>	<u>\$ 2,451,019</u>	<u>\$ 11,677,523</u>	<u>\$ 11,032,293</u>
Net expense	<u>\$(27,670,598)</u>	<u>\$(25,911,576)</u>	<u>\$ 74,317</u>	<u>\$ 10,643</u>	<u>\$(27,596,281)</u>	<u>\$(25,900,933)</u>
General revenues:						
General property taxes	\$ 19,696,597	\$ 17,119,607	\$ -	\$ -	\$ 19,696,597	\$ 17,119,607
Local sales and use taxes	1,257,370	1,183,750	-	-	1,257,370	1,183,750
Consumers utility taxes	1,371,649	1,263,288	-	-	1,371,649	1,263,288
Business license taxes	1,088,352	1,157,918	-	-	1,088,352	1,157,918
Other local taxes	2,293,641	2,584,457	-	-	2,293,641	2,584,457
Intergovernmental revenues-						
State	2,788,795	3,375,332	-	-	2,788,795	3,375,332
Proffers from new development	166,655	1,487,475	-	-	166,655	1,487,475
Other general revenues	373,891	365,403	86,626	87,405	460,517	452,808
Transfers	(123,380)	(1,869,598)	123,380	1,869,598	-	-
Total general revenues	<u>\$ 28,913,570</u>	<u>\$ 26,667,632</u>	<u>\$ 210,006</u>	<u>\$ 1,957,003</u>	<u>\$ 29,123,576</u>	<u>\$ 28,624,635</u>
Change in net assets	\$ 1,242,972	\$ 756,056	\$ 284,323	\$ 1,967,646	\$ 1,527,295	\$ 2,723,702
Net assets, beginning of year	<u>8,999,622</u>	<u>6,012,247</u>	<u>(134,305)</u>	<u>129,368</u>	<u>8,865,317</u>	<u>6,141,615</u>
Net assets, end of year	<u>\$ 10,242,594</u>	<u>\$ 6,768,303</u>	<u>\$ 150,018</u>	<u>\$ 2,097,014</u>	<u>\$ 10,392,612</u>	<u>\$ 8,865,317</u>

Expenditures in the County's governmental activities grew 6.6% over the prior year with expenditures increasing in every category. Education again consumed the largest share of

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

the total combined expenditures of the primary County government and its component unit during the fiscal year ended June 30, 2007 at 63% of the total. Public safety spending grew to 11% of the total. Program revenues, which include fees, charges and special purpose grants and contributions, funded 30% of total functional expenditures in fiscal year 2007, the same level as was recorded fiscal year 2006. Despite a 15% increase in general property tax revenues over the prior year, total general revenues for the County's governmental activities rose only 1.5%. In the County's business type activities, expenditures and revenues were relatively unchanged from the prior year though these activities, the County's water and sewer utility operations, are preparing for a period of substantial growth in the near future. It should again be noted that these expenses are on a full accrual basis and, therefore, include depreciation expense on capital assets.

Financial Analysis of the County's Funds

As noted earlier, the County uses fund accounting to ensure and demonstrate compliance with finance related legal requirements and for public accountability.

Governmental Funds. The focus of the County's governmental funds is to provide information on near-term inflows, outflows and balances of available resources. By analyzing the sources and uses of funds, the differences between the two, and changes in balances over time, such information can be useful in assessing the County's financial needs. In particular, unreserved fund balance is important as a measure of the net resources available for financing future expenditures.

In total, governmental funds reported fund balances of \$14,089,226 at June 30, 2007, \$4,310,061 of that balance is reserved by external restrictions and the remaining \$9,779,165 is unreserved. Fund balances in the governmental funds declined \$10,342,472 during the fiscal year ended June 30, 2007. The Capital Projects Fund balance dropped \$9,069,554 as \$8,175,366 in proceeds of long-term debt that was issued during the prior year were spent in the construction of the first new elementary school in the County in nearly 50 years. Expenditures for the renovation and expansion of the County Courthouse, a project that is near completion, were \$608,965 and \$1,030,573 was spent in the construction of a new Visitors Center for the County – and these projects also contributed to the \$13,364,814 in total spending in the Capital Projects Fund.

In the General Fund, fund balance declined to \$6,144,482 a 16% decrease over the prior year. General property taxes remain the primary revenue source in the General Fund contributing 65% of the total during fiscal year 2007, up from 58% in the prior year. Intergovernmental revenue from the Commonwealth of Virginia dropped to 15.5% of the total from 18% in the prior year and the share added by other local taxes dropped to 12% from 14% in fiscal year 2006. Education consumed the bulk of the General Fund's expenditures (39%). Public Safety (26%) and Public Works (12%) also accounted for substantial shares of the expenditures in the Fund.

Proprietary Funds. The proprietary funds provide the same type of information found in the business-type activities sections of the government-wide financial statements, but in more detail.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The largest of the County's enterprise operations, the County Public Utility Fund had a net deficit in net assets of \$1,032,123 at June 30, 2007. The County has made significant investments in the utility system over the last ten years that have not yet been fully recovered through revenues in the fund. The County's two functioning utility funds reported net operating losses for the fiscal year ended June 20, 2007, \$876,837 for the County Utility Fund and \$29,923 for the Milford Sanitary District. The Dawn Wastewater System is still under construction and is expected to begin regular operations in the next year.

General Fund Budgetary Highlights

In total, amendments to the original adopted budget of the General Fund amounted to only \$101,500, or less than 1% of the original budget. Following is a summary of the adjustments:

- \$53,000 for Public Safety – for additional part time court security staffing for the Sheriff's office
- \$40,000 for Judicial Administration – authorized expenditures were increased for the continuation of a grant funded Domestic Violence Prosecution program in the Commonwealth Attorney's office
- \$8,500 in other amendments

The budget for transfers out in the General Fund was also increased by \$63,350 for additional funding contributions to the Capital Projects Fund.

Actual revenue collections fell short of budget estimates by \$301,400, or 1%; revenue from property taxes and from permits, fees and regulatory licenses fell short of expectations as a slowing real estate market began to make itself felt in the County's revenues from property development activity. Other local tax collections, primarily taxes on business activity, partially offset these shortfalls by exceeding estimates by nearly 8%, or \$263,897. Revenue from the Commonwealth exceeded estimates by \$165,378 and revenue from the use of money and property also brought in \$106,262 more than expected due to strong investment management by the County Treasurer.

Actual expenditures and operating transfers out to other funds totaled \$511,220 less than the budget appropriations, a variance of only 1.6%. The functions of general government administration, judicial administration, and public works exceeded the final amended budget appropriation. Actual expenditures fell under amended appropriations in public safety, health and welfare, education, parks, recreation and cultural and community development and certain capital projects projected to be funded by transfers from the General Fund did not start as planned.

Capital Assets and Debt Administration

Capital Assets. The County's total investment in capital assets for governmental and business-type activities amounted to \$63,081,132 as of June 30, 2007, net of accumulated depreciation. This investment in capital assets includes land, buildings, property

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

improvements, machinery and equipment, vehicles and utility improvements. It should be noted that this investment value is based on historical cost and is not reflective of the current market value of these assets.

Major capital improvement projects for the year included:

- \$608,965 to continue the progress on the renovation of the existing Court building to accommodate the County Circuit Court. Prior stages of this project included construction of a new Courthouse Annex for the County's General District and Juvenile and Domestic Relations Courts
- \$1,030,573 for the construction of a Visitors Center to promote tourism and economic development in the County
- \$1,503,892 for primarily energy saving renovations at the County Middle School
- \$8,175,366 for construction of a new elementary school
- \$2,142,148 for construction of a decentralized wastewater system in the County's Dawn community to provide sewer service in an area plagued by chronic septic problems

Long-Term Debt. At June 30, 2007, the County's total long-term debt amounted to \$63,347,436. This total is comprised of:

- \$23,095,017 in lease revenue bonds issued through the County's Industrial Development Authority for a variety of general government and business-type activity improvements and equipment acquisitions.
- \$10,430,000 in bond anticipation notes for financing the construction of the new elementary school and for other school improvements
- \$18,529,325 in utility system revenue bonds for the improvement and expansion of the County's utility enterprise operations.
- \$4,978,973 in general obligation bonds issued for the construction and improvement of County public schools.
- \$1,354,617 in capital lease obligations for general government radio and motor vehicle equipment.
- \$4,529,493 as the County's liability for closure and post-closure care of the former County Sanitary Landfill.
- \$430,011 in accrued liabilities for leave benefits earned by County employees.

Payments made to retire County long-term debt totaled \$2,624,271 during the fiscal year ended June 30, 2007. Two long term debt transactions were completed during the fiscal year: a \$1,600,000 bond anticipation note that will help fund modernizing and energy saving renovations at the Caroline County Middle School and which will be refunded in the future with either proceeds from a State public school financing program or another long term debt issue; a \$1,647,399 revenue bond issued to access a State Wastewater Facilities Revolving Fund loan being used to help construct the Dawn Wastewater System.

Economic Factors and Next Year's Budget and Tax Rates

- The estimated population of Caroline County has grown 20% since the April 2000 census to an estimated 26,557 placing it among the fastest growing counties in Virginia.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

- The County conducted a real property reassessment for the January 2006 tax roll to be sure its values for tax purposes were in line with market values. Growth pushed assessed values up another 5% for the January 2007 to almost \$3 billion.
- 2006 was an extremely successful business investment year for the County and economic indicators confirmed that. The unemployment rate for the County dropped to 2.8%, local business growth was up 8.65%, jobs available increased 11.6% and weekly wages rose 14.9% (Virginia Department of Labor). is 3.4%, above the rate for the state of Virginia of 2.7% and the rate for the Richmond, Virginia metropolitan region in which Caroline County is located of 2.8%.
- The burst of population growth the County has experienced in the past few years has slowed dramatically as the nation-wide turnaround in real estate markets has had an impact. After issuing a total of 574 residential building permits in the fiscal year ended June 30, 2006, the County building inspection division only issued 318 in the fiscal year ended June 30, 2007 and is estimating those numbers will slide further to 294 in FY 2008. An upturn in commercial development is offsetting some of this drop, however, as the division expects permits for 25 new commercial structures in the fiscal year ending June 30, 2008, while only 11 were issued in FY 2007 and 15 in FY 2006.

These and many other factors were considered in preparing the County's budget for fiscal year 2008. The fiscal year 2008 operating budget (excluding capital investments) increased 5.2%. The real estate tax rate was left unchanged from the prior year at \$.48 per hundred dollars of assessed value for calendar year 2007.

Requests for Information

This financial report is designed to provide a general overview of the County of Caroline, Virginia's finances for all those who may have an interest in the County's financial condition and prospects. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Finance Director, Caroline County, Post Office Box 447, 117 Ennis Street, Bowling Green, VA 22427.