

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2008. 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 \$12,003,592 (Total Net Assets). Of this amount, \$5,648,842 is invested in capital assets (net of depreciation and related debt). The County is reporting a deficit in investment in capital assets, net of related debt of \$64,888.
- The County's total net assets increased by \$1,610,980, or 15.5%, in the fiscal year ended June 30, 2008.

Fund Financial Statements

- Total fund balance of the County's Governmental Funds, reporting on a current financial resources basis, amounted to \$11,272,727 at June 30, 2008. This was a decrease of \$2,816,499 over the prior year. 37% (\$1,771,671) of this decrease in fund balance was in the General Fund, due largely to the declining economy, an increase in deferred revenues and unplanned expenditures for solid waste and fire/rescue equipment.
- During the fiscal year ended June 30, 2008, the unreserved fund balance in the General Fund dropped by \$1,405,671 to \$4,372,811. This fund balance still represents 12.7% of total General Fund expenditures and operating transfers.
- The County's total outstanding long-term debt increased by \$23,900,380 to \$87,121,522 during the fiscal year ended June 30, 2008 for construction of a new elementary school, renovations to existing primary schools, purchase and renovation of a new county administration building, fire/rescue equipment and utility capital improvements.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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.

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 the Caroline County Utility Fund, the Milford Sanitary District Fund, also a public water utility, and the Dawn Wastewater System Fund, a public sewer utility.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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.

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 Required Supplementary Information in the Financial Section of this report to demonstrate compliance with this budget. Budgetary comparison statements for other governmental funds are also provided as Other 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, 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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. Combining financial statements and fund budgetary comparisons are also presented for the 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 \$12,003,592 at June 30, 2008. The following table summarizes the County's Statement of Net Assets:

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

County of Caroline, Virginia Net Assets

	Governmental Activities		Business-type Activities		Totals	
	2008	2007	2008	2007	2008	2007
Current and other assets	\$ 18,984,527	\$ 22,158,410	\$ (416,353)	\$ (3,364,112)	\$ 18,568,174	\$ 18,794,298
Capital assets	<u>58,889,304</u>	<u>40,808,413</u>	<u>27,610,308</u>	<u>22,272,719</u>	<u>86,499,612</u>	<u>63,081,132</u>
Total assets	<u>\$ 77,873,831</u>	<u>\$ 62,966,823</u>	<u>\$ 27,193,955</u>	<u>\$ 18,908,607</u>	<u>\$105,067,786</u>	<u>\$ 81,875,430</u>
Current liabilities	\$ 11,460,372	\$ 8,421,528	\$ 1,175,524	\$ 3,016,345	\$ 12,635,896	\$ 11,437,873
Long-term liabilities outstanding	<u>57,615,404</u>	<u>44,302,701</u>	<u>22,812,894</u>	<u>15,742,244</u>	<u>80,428,298</u>	<u>60,044,945</u>
Total liabilities	<u>\$ 69,075,776</u>	<u>\$ 52,724,229</u>	<u>\$ 23,988,418</u>	<u>\$ 18,758,589</u>	<u>\$ 93,064,194</u>	<u>\$ 71,482,818</u>
Net assets:						
Invested in capital assets, net of related debt	\$ (64,888)	\$ 6,625,002	\$ 5,713,730	\$ 5,729,267	\$ 5,648,842	\$ 12,354,269
Unrestricted	<u>8,862,943</u>	<u>3,617,592</u>	<u>(2,508,193)</u>	<u>(7,286,288)</u>	<u>6,354,750</u>	<u>(3,668,696)</u>
Total Net Assets	<u>\$ 8,798,055</u>	<u>\$ 10,242,594</u>	<u>\$ 3,205,537</u>	<u>\$ (1,557,021)</u>	<u>\$ 12,003,592</u>	<u>\$ 8,685,573</u>

The County is no longer reporting a deficit in the balance of unrestricted net assets due to the decrease in the deficit of the business type activities. A portion of the County's assets, \$1,762,655, 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 \$7,365,425 at June 30, 2007 to \$5,932,278. The County's investment in capital assets decreased by \$6,705,427 and its long term liabilities increased by \$20,383,353 over the same period.

As previously indicated, the County's net assets grew \$1,610,980. Net assets of governmental activities decreased by \$1,444,539 and those of business-type activities, the County's water and sewer utility operations, increased \$2,875,519. The following table summarizes the change in the County's net assets as shown in the Statement of Activities:

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

County of Caroline, Virginia Changes in Net Assets

	Governmental Activities		Business-type Activities		Totals	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Expenses:						
General Government						
Administration	\$ 3,568,313	\$ 3,074,553			\$ 3,568,313	\$ 3,074,553
Judicial Administration	1,155,295	998,181			1,155,295	998,181
Public Safety	11,871,594	8,517,661			11,871,594	8,517,661
Public Works	1,992,373	3,984,895			1,992,373	3,984,895
Health and Welfare	4,298,184	3,765,455			4,298,184	3,765,455
Education	13,677,703	11,325,718			13,677,703	11,325,718
Parks, Recreation, and Cultural	652,192	958,698			652,192	958,698
Community Development	1,802,204	2,139,000			1,802,204	2,139,000
Interest and Other fiscal charges	2,384,813	2,015,260			2,384,813	2,015,260
Water and Sewer Utilities	-	-	3,310,499	2,494,383	3,310,499	2,494,383
Total Expenses	<u>\$ 41,402,671</u>	<u>\$ 36,779,421</u>	<u>\$ 3,310,499</u>	<u>\$ 2,494,383</u>	<u>\$ 44,713,170</u>	<u>\$ 39,273,804</u>
Less: Program Revenues						
Charges for Services	\$ 1,969,105	\$ 2,126,720	\$ 2,306,221	\$ 1,036,029	\$ 4,275,326	\$ 3,162,749
Operating Grants and Contributions	5,180,181	5,336,087	107,000	-	5,287,181	5,336,087
Capital Grants and Contributions	292,906	1,646,016	3,766,990	1,532,671	4,059,896	3,178,687
Total Program Revenues	<u>\$ 7,442,192</u>	<u>\$ 9,108,823</u>	<u>\$ 6,180,211</u>	<u>\$ 2,568,700</u>	<u>\$ 13,622,403</u>	<u>\$ 11,677,523</u>
Net Expense	<u>\$ (33,960,479)</u>	<u>\$ (27,670,598)</u>	<u>\$ 2,869,712</u>	<u>\$ 74,317</u>	<u>\$ (31,090,767)</u>	<u>\$ (27,596,281)</u>
General Revenues:						
General Property Taxes	\$ 21,721,562	\$ 19,696,597			\$ 21,721,562	\$ 19,696,597
Local Sales and Use Taxes	1,397,232	1,257,370			1,397,232	1,257,370
Consumers Utility Taxes	81,756	1,371,649			81,756	1,371,649
Business License Taxes	1,099,579	1,088,352			1,099,579	1,088,352
Other Local Taxes	4,666,971	2,293,641			4,666,971	2,293,641
Intergovernmental Revenues-State	2,450,226	2,788,795			2,450,226	2,788,795
Proffers From New Development	304,908	166,655			304,908	166,655
Other General Revenues	909,344	373,891	70,169	86,626	979,513	460,517
Transfers	(115,638)	(123,380)	115,638	123,380	-	-
Total General Revenues	<u>\$ 32,515,940</u>	<u>\$ 28,913,570</u>	<u>\$ 185,807</u>	<u>\$ 210,006</u>	<u>\$ 32,701,747</u>	<u>\$ 29,123,576</u>
Change in Net Assets	<u>\$ (1,444,539)</u>	<u>\$ 1,242,972</u>	<u>\$ 3,055,519</u>	<u>\$ 284,323</u>	<u>\$ 1,610,980</u>	<u>\$ 1,527,295</u>
Net Assets, Beginning of Year	<u>10,242,594</u>	<u>8,999,622</u>	<u>150,018</u>	<u>(134,305)</u>	<u>10,392,612</u>	<u>8,865,317</u>
Net Assets, Ending of Year	<u>\$ 8,798,055</u>	<u>\$ 10,242,594</u>	<u>\$ 3,205,537</u>	<u>\$ 150,018</u>	<u>\$ 12,003,592</u>	<u>\$ 10,392,612</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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 the total combined expenditures of the primary County government and its component unit during the fiscal year ended June 30, 2008 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.

The remainder of this page left blank intentionally