

Management's Discussion and Analysis

As management of Harnett County, we offer readers of Harnett County's financial statements this narrative overview and analysis of the financial activities of Harnett County for the fiscal year ended June 30, 2003. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the County's financial statements, which follow this narrative.

Financial Highlights

- The assets of Harnett County exceeded its liabilities at the close of the fiscal year by \$57,458,619 (*net assets*).
- The government's total net assets decreased by \$7,412,822, primarily due to decreased net assets associated with the Governmental Activities.
- In accordance with North Carolina law, liabilities of the County include approximately \$32,010,770 in long-term debt associated with assets belonging to the Harnett County Board of Education and Central Carolina Community College. As these assets are not reflected in the County's financial statements and the full amount of the long-term debt is reflected in the County's financial statements, the County reports a corresponding lower net asset amount.
- As of the close of the current fiscal year, Harnett County's governmental funds reported combined ending fund balances of \$33,057,451, a decrease of \$15,125,023 in comparison with the prior year. Approximately 59.76% of this total amount, or \$19,753,575, is available for spending at the government's discretion (*unreserved fund balance*).
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$3,967,485, or 5.98% percent of total general fund expenditures for the fiscal year.
- Harnett County's total debt decreased by \$5,199,180 (4.33%) during the current fiscal year. The key factor in this decrease was the payment of debt principal.
- Harnett County maintained its A3 and A bond ratings for Certificates of Participation and Aaa and AAA bond rating for General Obligations.

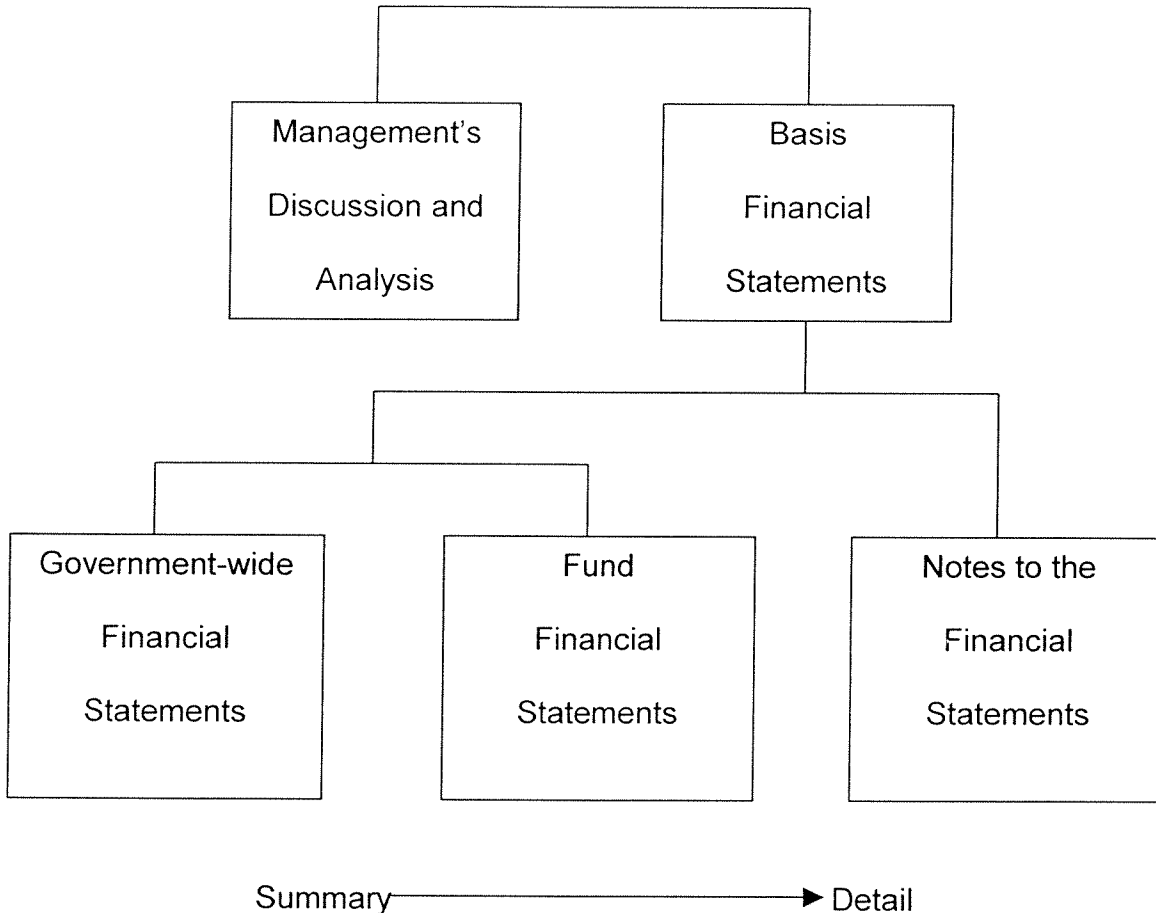
Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Harnett County's basic financial statements. The County's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements (see Figure 1). The basic financial statements present two different views of the County through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental

information that will enhance the reader's understanding of the financial condition of Harnett County.

Required Components of Annual Financial Report

Figure 1



Basic Financial Statements

The first two statements (Pages 16 and 17) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the County's financial status.

The next statements (Pages 18 through 29) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the County's government. These statements provide more detail than the government-wide statements. There are four parts to the Fund Financial Statements: 1) the governmental funds statements; 2) the budgetary comparison statements; 3) the proprietary fund statements; and 4) the fiduciary fund statement.

The next section of the basic financial statements is the **notes**. The notes to the financial statements explain in detail some of the data contained in those statements. After the notes, **supplemental information** is provided to show details about the County's non-major governmental funds, all of which are added together in one column on the basic financial statements. Budgetary information required by the General Statutes also can be found in this part of the statements.

Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the County's finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the County's financial status as a whole.

The two government-wide statements report the County's net assets and how they have changed. Net assets are the difference between the County's total assets and total liabilities. Measuring net assets is one way to gage the County's financial condition.

The government-wide statements are divided into two categories: 1) governmental activities; and 2) business-type activities. The governmental activities include most of the County's basic services such as general government, public safety, environmental protection, transportation, economic and physical development, human services, cultural and recreational and education. Property taxes and state and federal grant funds finance most of these activities. The business-type activities are those that the County charges customers to provide. These include the water and sewer and solid waste services offered by Harnett County.

The government-wide financial statements are on Pages 16 and 17 of this report.

Fund Financial Statements

The fund financial statements provide a more detailed look at the County's most significant activities. 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. Harnett County, like all other governmental entities in North Carolina, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the County's budget ordinance. All of the funds of Harnett County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds – Governmental funds are used to account for those functions reported as governmental activities in the government-wide financial statements. Most of the County's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash flow in and out, and what monies are left at year-end that will be available for spending in the next year. Governmental funds are reported using an accounting method called *modified accrual accounting* which provides a current financial resources focus. As a result, the governmental fund financial statements give the reader a detailed short-term view that helps him or her determine if there are more or less financial resources available to finance the County's programs. The relationship between government activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

Harnett County adopts an annual budget for its General Fund, as required by the General Statutes. The budget is a legally adopted document that incorporates input from the citizens of the County, the management of the County, and the decisions of the Board about which services to provide and how to pay for them. It also authorizes the County to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund demonstrates how well the County complied with the budget ordinance and whether or not the County succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement uses the budgetary basis of accounting and is presented using the same format, language, and classifications as the statement of revenues, expenditures and changes in fund balances. The statement shows four columns: 1) the original budget as adopted by the board; 2) the final budget as amended by the board; 3) the actual resources, charges to appropriations, and ending balances in the General Fund; and 4) the difference or variance between the final budget and the actual resources and charges.

Proprietary Funds – Harnett County has one kind of proprietary fund. *Enterprise Funds* are used to report the same functions presented as business-type activities in the government-wide financial statements. Harnett County uses enterprise funds to account for its water and sewer activity and for its solid waste management fund. This fund is the same as those functions shown in the business-type activities in the Statement of Net Assets and the Statement of Activities.

Agency Funds – Agency funds are used to account for assets the County holds on behalf of others. The County has two agency funds.

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. The notes to the financial statements are on pages 30 through 72 of this report.

Other Information – In addition to the basic financial statements and accompanying notes, this report includes certain required supplementary information concerning Harnett County's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found beginning on page 73 of this report.

Government-Wide Financial Analysis

The government-wide financial statements for the fiscal year ended June 30, 2003, are the beginning of a new era in financial reporting for Harnett County, and many other units of government across the United States. Prior to this year, Harnett County maintained their governmental and proprietary fund groups as two separate and very distinct types of accounting without any type of consolidated statement that accurately reflected the operations and net assets of the government as a whole. There was a total column that appeared on the financial statements, but it was a memorandum total only. No attempt was made to adjust the statements in such a way that the total column would represent the overall financial condition of Harnett County. These statements were basically the equivalent of the fund financial statements that appear in this report with fiduciary funds and two account groups, the long-term debt and the general fixed assets, added in.

The changes in the financial statement reporting model are mandated by the Government Accounting Standards Board (GASB). GASB Statement 34 dictated the changes you see in Harnett County's financial reports as well as those of many other units of government. While Harnett County was required to implement these changes for the fiscal year ended June 30, 2003, other units may not be required to implement until 2004.

Because of the new reporting model, comparative data for all facets of this report are not available. When comparative numbers are accessible, they have been included, such as with net assets. Future years' reports will have more comparative data that will allow more opportunities for comparative analysis.

Harnett County's Net Assets

Figure 2

	Governmental Activities	Business-type Activities	Total Primary Government
	2003	2003	2003
Assets			
Cash and investments	\$ 23,314,421	\$ 5,402,583	\$ 28,717,004
Taxes receivable, net	2,823,394	91,783	2,915,177
Accounts receivable, net	6,080,857	1,847,306	7,928,163
Inventories	10,454	273,120	283,574
Cash on deposit with escrow agent	5,315,386	-	5,315,386
Bond issue costs, net	-	81,002	81,002
Capital assets:			
Nondepreciable	22,978,484	16,735,785	39,714,269
Depreciable	16,798,499	78,774,375	95,572,874
Total assets	77,321,495	103,205,954	180,527,449
Liabilities			
Accounts payable and accrued liabilities	1,044,496	386,799	1,431,295
Accrued interest payable	371,970	321,175	693,145
Customer deposits	-	559,358	559,358
Unearned revenue	619,171	33,349	652,520
Long-term liabilities:			
Due in less than one year	5,353,450	2,511,500	7,864,950
Due in more than one year	73,823,798	38,043,764	111,867,562
Total liabilities	81,212,885	41,855,945	123,068,830
Net assets			
Capital assets, net of related debt	20,511,775	57,333,007	77,844,782
Restricted for:			
Capital projects	260,154	-	260,154
Debt Service	5,558,331	-	5,558,331
Unrestricted	(30,221,650)	4,017,002	(26,204,648)
Total net assets	\$ (3,891,390)	\$ 61,350,009	\$ 57,458,619

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of Harnett County exceeded liabilities by \$57,458,619 as of June 30, 2003. The County's net assets decreased by \$7,412,822 for the fiscal year ended June 30, 2003. The largest portion totaling \$77,844,782 reflects the County's investment in capital assets (e.g. land, buildings, machinery, and equipment), less any related debt still outstanding that was issued to acquire those items. Harnett County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Harnett County's investment in its capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities. An additional portion of Harnett County's net assets totaling \$260,154 for capital projects and \$5,558,331 for debt service represents resources that are subject to external restrictions on how they may be used. The remaining deficit balance of (\$26,204,648) is unrestricted.

As with many counties in the State of North Carolina, the County's *unrestricted net assets*, is low or negative due primarily to the portion of the County's outstanding debt incurred for the County Board of Education (the "school system") and Central Carolina Community College (CCCC). Under North Carolina law, the County is responsible for providing capital funding for the school systems. The County has chosen to meet its legal obligation to provide the school systems capital funding by using a mixture of County funds and general obligation debt. The assets funded by the County, however, are owned and utilized by the school systems. Since the County, as the issuing government, acquires no capital assets, the County has incurred a liability without a corresponding increase in assets. At the end of the fiscal year, approximately \$32,010,770 of the outstanding debt on the County's financial statements was related to assets included in the school systems' financial statements. However, since the majority of this school systems related debt is general obligation debt, it is collateralized by the full faith, credit and taxing power of the County. Accordingly, the County is authorized and required by State law to levy ad valorem taxes, without limit as to rate or amount, as may be necessary to pay the debt service on its general obligation bonds. Principal and interest requirements will be provided by an appropriation in the year which they become due.

Several particular aspects of the County's financial operations positively influenced the total unrestricted governmental net assets:

- *Continued diligence in the collection of property taxes by maintaining a collection percentage of 93.54%, which is slightly lower than the 2002 statewide average of 95.42% for the County's population group.*
- *Increased charges for services revenue due to growth in the use of County facilities.*
- *Continued low cost of debt due to the County's high bond rating*

**Harnett County Changes in Net Assets
Figure 3**

HARNETT COUNTY'S CHANGES IN NET ASSETS

	Governmental Activities 2003	Business-type Activities 2003	Total 2003
Revenues:			
Program revenues:			
Charges for services	\$ 8,019,800	\$ 14,299,479	\$ 22,319,279
Operating grants and contributions	18,671,134	-	18,671,134
Capital grants and contributions	17,478	4,918,071	4,935,549
General revenues:			
Property taxes	30,862,061	85,681	30,947,742
Other taxes	13,893,614	-	13,893,614
Grants and contributions not restricted to specific programs	48,741	-	48,741
Other	1,834,653	130,994	1,965,647
Total revenues	<u>73,347,481</u>	<u>19,434,225</u>	<u>92,781,706</u>
Expenses:			
General government	9,118,050	-	9,118,050
Public safety	15,824,691	-	15,824,691
Environmental Protection	336,670	-	336,670
Transportation	156,504	-	156,504
Economic and physical development	3,179,192	-	3,179,192
Human services	22,825,213	-	22,825,213
Cultural and recreation	889,600	-	889,600
Education	28,737,978	-	28,737,978
Interest on long-term debt	4,669,096	-	4,669,096
Landfill	-	2,803,091	2,803,091
Water and sewer	-	11,654,443	11,654,443
Total expenses	<u>85,736,994</u>	<u>14,457,534</u>	<u>100,194,528</u>
Increase in net assets before transfers	(12,389,513)	4,976,691	(7,412,822)
Transfers	851,269	(851,269)	-
Increase/(decrease) in net assets	(11,538,244)	4,125,422	(7,412,822)
Net assets, July 1	<u>7,646,854</u>	<u>57,224,587</u>	<u>64,871,441</u>
Net assets, June 30	<u>\$ (3,891,390)</u>	<u>\$ 61,350,009</u>	<u>\$ 57,458,619</u>

Governmental activities. Governmental activities decreased the County's net assets by \$11,538,244. Key elements of this decrease are as follows:

- The decrease to net assets was due to capital project expenses for the COPS 2002 School Construction Project. These expenses are not capitalized rather they are expensed as payments to the Board of Education. There were higher expenses in the current year due to a new project.

Business-type activities: Business-type activities increased Harnett County's net assets by \$4,125,422.

- The number of customers and water and sewer connections continued to increase.
- Increase in the amount of capital grants and contributions received.

Financial Analysis of the County's Funds

As noted earlier, Harnett County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds. The focus of Harnett County's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing Harnett County's financing requirements. Specifically, unreserved fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

The general fund is the chief operating fund of Harnett County. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$3,967,485, while total fund balance reached \$11,543,031. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 5.98% of total General Fund expenditures, while total fund balance represents 17.38% percent of that same amount.

At June 30, 2003, the governmental funds of Harnett County reported a combined fund balance of \$33,057,451, a 31.40% decrease over last year. The primary reason for this decrease is the decrease in fund balance in the COPS 2002 School Construction Capital Project.

General Fund Budgetary Highlights: During the fiscal year, the County revised the budget on several occasions. Generally, budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants; and 3) increases in appropriations that become necessary to maintain services. Total amendments to the General Fund increased revenues by \$4,981,703, a material amount. This increase was due to the receipt of sales and use tax and various restricted intergovernmental revenues throughout the year.

Proprietary Funds. Harnett County's proprietary funds provide the same type of information found in the government-wide statements but in more detail. Unrestricted net assets of the Landfill Fund at the end of the fiscal year amounted to \$867,314, and those for the Water and Sewer Fund equaled \$3,529,101. The total growth in net assets for both funds was \$28,296 and \$4,097,126 respectively. Other factors concerning the finances of these two funds have already been addressed in the discussion of Harnett County's business-type activities.

Capital Asset and Debt Administration

Capital assets. Harnett County's investment in capital assets for its governmental and business-type activities as of June 30, 2003, totals \$151,394,876 (net of accumulated depreciation). These assets include buildings, land, construction in progress, buildings, land improvements, furniture, computer hardware, computer software, fixtures, machinery and equipment, park facilities, vehicles and plant distribution and collection systems.

Major capital asset transactions during the year include:

- Purchased new vehicles for the Public Safety Department
- Purchased new ambulance for EMS
- Purchased computers and software for various departments in the County
- Addition of construction in progress on Water and Sewer plant facilities and Airport construction projects
- Addition of several contributed water lines

**Harnett County's Capital Assets
(net of depreciation)**

Figure 4

	Governmental Activities		Business-type Activities		Total
	2003		2003		2003
Land	\$	4,546,634	\$	1,032,251	\$ 5,578,885
Plant, distribution and collection systems		-		77,116,762	77,116,762
Buildings		13,324,579		703,263	14,027,842
Land Improvements		1,087,706		-	1,087,706
Furniture, fixtures and equipment		1,010,182		435,446	1,445,628
Computer hardware		148,046		-	148,046
Computer software		32,143		-	32,143
Vehicles		1,195,843		518,904	1,714,747
Construction in progress		18,431,850		15,703,534	34,135,384
Total	\$	39,776,983	\$	95,510,160	\$ 135,287,143

Additional information on the County's capital assets can be found in Note 7 of the Basic Financial Statements.

Long-term Debt. The County issues general obligation bonds to fund the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the County. At June 30, 2003, general obligation bonds consist of:

Harnett County's Outstanding Debt

Figure 5

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
General obligation bonds	\$	-	\$	-	\$ 18,922,200	\$ 19,454,350
Installment purchase	76,832,713	80,552,021	10,297,150	11,410,218	87,129,863	91,962,239
Capitalized leases	950,922	1,281,200	77,502	97,465	1,028,424	1,378,665
State Bond loan	-	-	7,761,387	7,245,800	7,761,387	7,245,800
Total	\$ 77,783,635	\$ 81,833,221	\$ 37,058,239	\$ 38,207,833	\$ 114,841,874	\$ 120,041,054

Harnett County's total debt decreased by \$5,199,180 (4.33%) during the past fiscal year, primarily due to regularly scheduled principal payments.

As mentioned in the financial highlights section of this document, Harnett County maintained its A3 and A bond rating for Certificates of Participation and Aaa and AAA bond rating for General Obligations from Moody's Investor Service and AAA rating from Standard and Poor's Corporation and FitchRatings. These bond ratings are a clear indication of the sound financial condition of Harnett County.

The State of North Carolina limits the amount of general obligation debt that a unit of government can issue to 8 percent of the total assessed value of taxable property located within that government's boundaries. The legal debt margin for Harnett County is \$164,203,420. The County has \$42,606,000 in bonds authorized but un-issued at June 30, 2003.

Additional information regarding Harnett County's long-term debt can be found in notes 11 and 12 on pages 53 through 62 of this report.

Economic Factors and Next Year's Budgets and Rates

The following key economic indicators reflect the growth and prosperity of the County.

- The unemployment rate for Harnett County for the fiscal year ending June 30, 2003 was 8.00%, which is a decrease from a rate of 8.9% a year ago. Compared to the State average of 6.9% for the same period, the County has a higher rate due to the sluggish economy but continues to improve.
- The loss of State reimbursements continued to create revenue shortfalls for the County during the fiscal year. This loss of revenue was replaced by the additional Local Option Sales Tax during the year.

Budget Highlights for the Fiscal Year Ending June 30, 2004

Governmental Activities: Property taxes (benefiting from the economic growth) and revenues from permits and fees are expected to lead the increase in revenue projections by 6.35% percent. The County will use these increases in revenues to finance programs currently in place.

Budgeted expenditures in the General Fund are expected to rise 5% to \$73,765,886. The largest increments are in employee compensation, including funding compensation and benefits adjustments.

Business – type Activities: The water and sewer rates will be maintained at the current level and continue to cover the cost of operations. General operating expenses will increase by 9% to cover increased personnel costs, and 9% to cover increased costs of material, supplies, and other operating expenses. Rates for landfill services will not increase.

Requests for Information

This report is designed to provide an overview of the County's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance, Harnett County, P.O. Box 760 102 East Front Street Lillington, NC 27546.