



Martin Starnes & Associates, CPAs, P.A.

A Professional Association of Certified Public Accountants and Management Consultants

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Lincoln County, North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lincoln County, North Carolina, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Lincoln County's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. We did not audit the financial statements of the Lincoln County ABC Board which represents 11.7 percent, 1 percent, and 52.5 percent, respectively, of the assets, net assets and revenues of the discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Lincoln County ABC Board is based solely on the report of the other auditor.

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 basic financial statements are free of material misstatement. The financial statements of Lincoln County ABC Board were not audited in accordance with *Government Auditing Standards*. 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 significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of Lincoln County, North Carolina, as of June 30, 2006, and the respective changes in financial position and cash flows, where appropriate, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis, Schedules of Funding Progress, Employer Contributions, and Notes to the Required Schedules for the Law Enforcement Officer's Special Separation Allowance are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion thereon.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 13, 2006, on our consideration of Lincoln County's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on financial statements that collectively comprise the basic financial statements of Lincoln County, North Carolina. The introductory information, combining and individual nonmajor fund schedules, the statistical tables, as well as the accompanying schedule of expenditures of federal and State awards as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Not-Profit Organizations*, and the State Single Audit Implementation Act, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial schedules and the accompanying schedule of expenditures of federal and State awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic financial statements taken as a whole. The introductory information and the statistical tables have not been subjected to the auditing procedures applied in the audit of basic financial statements and, accordingly, we express no opinion on them.

Martin Starnes & Associates, CPAs, P.A.

Martin Starnes & Associates, CPAs, P.A.

October 13, 2006

Management's Discussion and Analysis

As management of Lincoln County, we offer readers of Lincoln County's financial statements this narrative overview and analysis of the financial activities of Lincoln County for the fiscal year ended June 30, 2006. 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

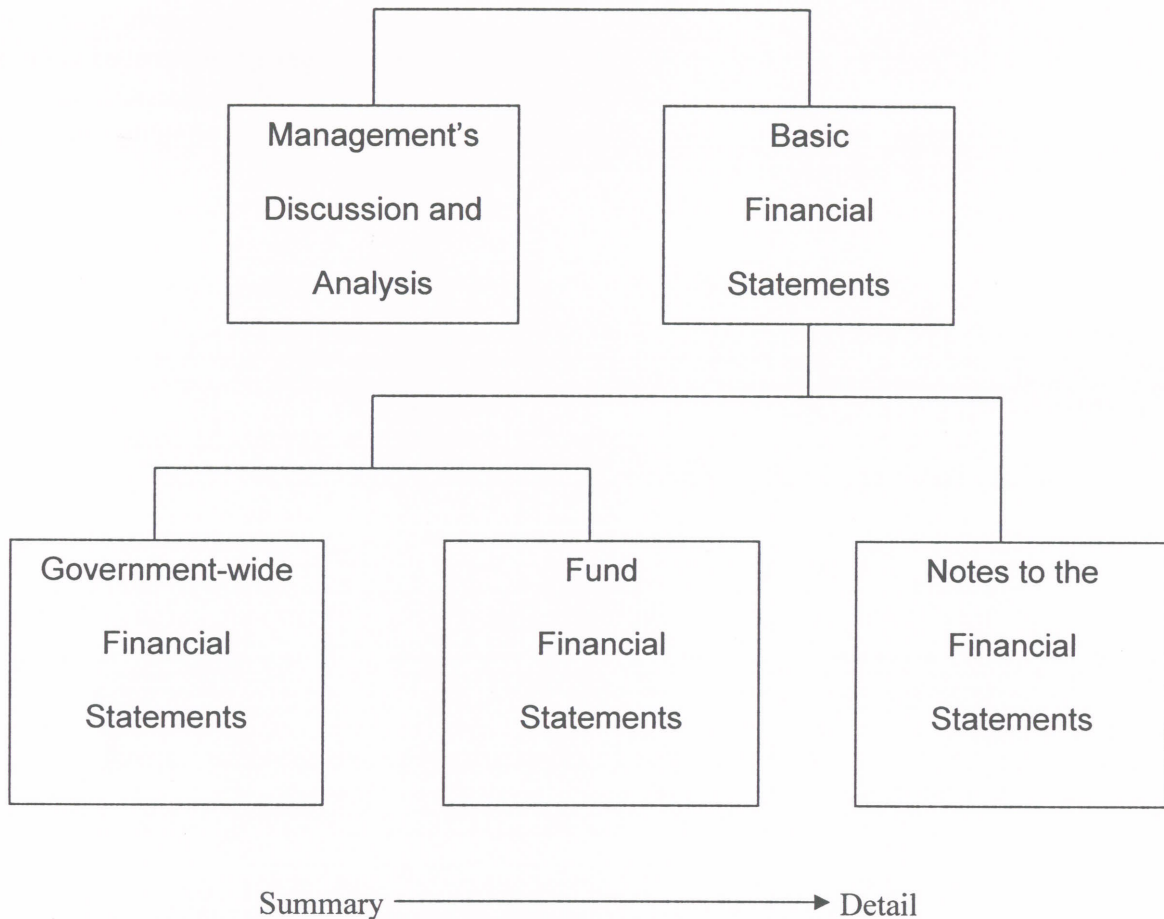
- The assets of Lincoln County exceeded its liabilities at the close of the fiscal year by \$8,175,661 (*net assets*).
- Current year operations and debt issuances decreased the government's total net assets by \$20,006,434.
- As of the close of the current fiscal year, Lincoln County's governmental funds reported combined ending fund balances of \$51,377,595, an increase of \$19,647,377 in comparison with the prior year amount. This increase was primarily due to an increase in School Capital Project funds. Approximately 86.9 percent of this total amount, or \$44,688,791, 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 \$12,218,849, or 18.29 percent of total general fund expenditures for the fiscal year. In 2005, unreserved fund balance in the General Fund was \$14,040,465, or 22.81% of total expenditures.
- Lincoln County's total debt increased by \$22,340,000, 28.28% during the current fiscal year. The key factor in this increase was the issuance of \$28.0 million of new general obligation school bonds.
- Lincoln County maintained its A2 bond rating from Moody's Investors Service; an A rating from Standard & Poor's; and an AA- rating from Fitch Ratings.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to Lincoln 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 Lincoln County.

Required Components of Annual Financial Report

Figure 1



Basic Financial Statements

The first two statements (Exhibits A and B) 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 (Exhibits C through J) are the **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 statements.

The next section of the basic financial statements is the **Notes to the Basic Financial Statements**. 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 individual funds. 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 gauge the County's financial condition.

The government-wide statements are divided into three categories: 1) governmental activities; 2) business-type activities; and 3) component units. The governmental activities include most of the County's basic services such as public safety, parks and recreation, and general administration. 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 landfill services offered by Lincoln County. The final category is the component units. Although legally separate from the County, the ABC Board is important to the County because the County is financially accountable for the Board by appointing its members and because the Board is required to distribute its profits to the County. The Lincoln-Lincoln County Regional Airport Authority is a legally separate entity; however, the County provides a significant level of support, including grants, leases, and accounting support services.

The government-wide financial statements are on Exhibits A and B 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. Lincoln 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 Lincoln 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*. This method also has 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.

Lincoln 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 legal budget document. 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. To account for the difference between the budgetary basis of accounting and the modified accrual basis, a reconciliation showing the differences in the reported activities is shown at the end of the budgetary statement.

Proprietary Funds – Lincoln 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. Lincoln County uses enterprise funds to account for its water and sewer activity and for its landfill operations. These funds are the same as those separate activities shown in the business-type activities in the Statement of Net Assets and the Statement of Activities.

Fiduciary Funds – Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Lincoln County has three fiduciary funds, which are 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 start after Exhibit J of this report.

Other Information – In addition to the basic financial statements and accompanying notes, this report includes certain required supplementary information concerning Lincoln County's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information starts after the notes to the financial statements.

Lincoln County's Net Assets

Figure 2

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Current and other assets	\$ 59,027,591	\$ 39,957,232	\$ 15,000,193	\$ 17,873,751	\$ 74,027,784	\$ 57,830,983
Capital assets	27,306,626	26,815,193	59,008,316	52,138,364	86,314,942	78,953,557
Total assets	<u>\$ 86,334,217</u>	<u>\$ 66,772,425</u>	<u>\$ 74,008,509</u>	<u>\$ 70,012,115</u>	<u>\$ 160,342,726</u>	<u>\$ 136,784,540</u>
Long-term liabilities outstanding	\$ 123,391,737	\$ 78,170,952	\$ 21,222,464	\$ 23,283,962	\$ 144,614,201	\$ 101,454,914
Other liabilities	6,308,708	6,506,647	1,244,156	640,884	7,552,864	7,147,531
Total liabilities	<u>129,700,445</u>	<u>84,677,599</u>	<u>22,466,620</u>	<u>23,924,846</u>	<u>152,167,065</u>	<u>108,602,445</u>
Net Assets:						
Invested in capital assets, net of related debt	19,783,230	18,771,801	41,920,528	33,682,907	61,703,758	52,454,708
Unrestricted	(63,149,458)	(36,676,975)	9,621,361	12,404,362	(53,528,097)	(24,272,613)
Total net assets	<u>\$ (43,366,228)</u>	<u>\$ (17,905,174)</u>	<u>\$ 51,541,889</u>	<u>\$ 46,087,269</u>	<u>\$ 8,175,661</u>	<u>\$ 28,182,095</u>

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of Lincoln County exceeded liabilities by \$8,175,661 as of June 30, 2006. The County's net assets decreased by \$20,006,434 for the fiscal year ended June 30, 2006. One of the largest portions (53.8 %) 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. Lincoln County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Lincoln 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 Lincoln County's net assets (< 1%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of (\$53,528,097) is unrestricted.

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 97.63%, higher than the statewide average of 96.10%.
- Increased ad valorem tax and sales tax revenue due to growth in County.
- 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.

Lincoln County's Changes in Net Assets
Figure 3

LINCOLN COUNTY'S CHANGES IN NET ASSETS

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues:						
Charges for services	\$ 8,820,739	\$ 8,581,875	\$ 10,778,428	\$ 9,916,950	\$ 19,599,167	\$ 18,498,825
Operating grants and contributions	9,664,316	9,020,561	-	-	9,664,316	9,020,561
Capital grants and contributions	23,212	100,838	1,363,663	1,031,210	1,386,875	1,132,048
General revenues:						
Property taxes	38,185,874	36,774,263	1,547,152	1,806,680	39,733,026	38,580,943
Other taxes	16,100,188	14,741,445	-	-	16,100,188	14,741,445
Other	2,211,472	1,199,292	956,680	342,074	3,168,152	1,541,366
Total revenues	<u>75,005,801</u>	<u>70,418,274</u>	<u>14,645,923</u>	<u>13,096,914</u>	<u>89,651,724</u>	<u>83,515,188</u>
Expenses:						
General government	8,021,462	7,104,432	-	-	8,021,462	7,104,432
Public safety	17,514,812	16,173,103	-	-	17,514,812	16,173,103
Environmental protection	91,252	104,464	-	-	91,252	104,464
Economic and physical development	1,138,483	1,266,878	-	-	1,138,483	1,266,878
Human services	19,037,216	17,870,817	-	-	19,037,216	17,870,817
Cultural and recreation	1,614,685	1,584,772	-	-	1,614,685	1,584,772
Education	49,001,212	22,437,377	-	-	49,001,212	22,437,377
Interest on long-term debt	4,047,733	3,340,656	-	-	4,047,733	3,340,656
Landfill	-	-	3,429,851	2,735,135	3,429,851	2,735,135
Water and sewer	-	-	5,761,452	5,308,991	5,761,452	5,308,991
Total expenses	<u>100,466,855</u>	<u>69,882,498</u>	<u>9,191,303</u>	<u>8,044,126</u>	<u>109,658,158</u>	<u>77,926,625</u>
Increase (decrease) in net assets	(25,461,054)	535,776	5,454,620	5,052,788	(20,006,434)	5,588,564
Net assets, beginning	<u>(17,905,174)</u>	<u>(18,440,950)</u>	<u>46,087,269</u>	<u>41,034,481</u>	<u>28,182,095</u>	<u>22,593,531</u>
Net assets, ending	<u>\$ (43,366,228)</u>	<u>\$ (17,905,174)</u>	<u>\$ 51,541,889</u>	<u>\$ 46,087,269</u>	<u>\$ 8,175,661</u>	<u>\$ 28,182,095</u>

Governmental Activities. Governmental activities decreased the County's net assets by (\$25,461,054) thereby accounting for the total decrease in the net assets of Lincoln County. The key elements of this decrease in 2006 were increased expenditures for public safety, human resources, interest on debt, and education that were partially offset by increased property tax, other taxes, and operating grant revenues.

Business-type Activities: Business-type activities increased Lincoln County's net assets by \$5,454,620. This was decreased by the "Governments activities" reduction. Together there was a total net asset decrease of (\$20,006,434).

Financial Analysis of the County's Funds

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

Governmental Funds. The focus of Lincoln County's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing Lincoln 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 Lincoln County. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$12,218,849, while total fund balance reached \$18,361,348. 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 18.29 percent of total General Fund expenditures, while total fund balance represents 27.48 percent of that same amount.

At June 30, 2006, the governmental funds of Lincoln County reported a combined fund balance of \$51,377,595, a 61.92 percent increase over last year. The primary reason for this increase was the increase of school capital funds available during the year due to the issuance of \$28,000,000 school bonds and \$21,645,000 of school installment financing for the beginning of another construction 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 \$2,426,020. The majority of this increase was in restricted revenues to account for additional grants received, increased sales and services for increase in ambulance services, and sale of fixed assets. Expenditures increased by \$2,923,353 to account for grants in public safety, economic and physical development, human services and general government. Actual revenues for Ad Valorem Taxes was approximately \$1.4 million more than budget, while Local Option Sales Taxes were \$1 million greater than the budgeted amount. The excess of actual revenues over budgeted revenues is due to Lincoln County's conservative budgeting process. Expenditures for human services were approximately \$2.56 million less than budgeted amounts due to lower than expected activity. Appropriated fund balance was significantly less than originally budgeted due to the increases in revenues and decreases in expenditures noted above.

Proprietary Funds. Lincoln 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 \$3,070,724, the Water and Sewer Fund equaled \$2,712,989 and those for the East Lincoln County Water and Sewer District equaled \$3,837,648. The total growth in net assets for the three funds,

were (\$390,341), \$3,354,666 and \$2,490,295, respectively. The decrease in the Landfill Fund was due to the construction of an additional lined cell at the landfill to enable the landfill to continue to accept waste. Other factors concerning the finances of these funds have already been addressed in the discussion of Lincoln County's business-type activities.

Capital Asset and Debt Administration

Capital Assets. Lincoln County's capital assets for its governmental and business – type activities as of June 30, 2006, totals \$86,314,942 (net of accumulated depreciation). These assets include buildings, land, water and sewer line and treatment facilities, machinery and equipment, park facilities, and vehicles.

Major capital asset transactions during the year include:

- Purchased new vehicles for Law Enforcement and various other departments
- Construction of new water distribution lines
- Expansion of Wastewater Treatment facility
- Construction of new cell at landfill
- Sold land in industrial park to new industry

Lincoln County's Capital Assets (net of depreciation)

Figure 4

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land	\$ 1,794,703	\$ 1,917,667	\$ 690,367	\$ 650,750	\$ 2,485,070	\$ 2,568,417
Buildings and structures	14,667,499	15,123,099	19,113,119	19,604,905	33,780,618	34,728,004
Other improvements	3,501,900	3,360,427	4,626,144	618,992	8,128,044	3,979,419
Machinery and equipment	3,035,035	2,835,238	2,879,865	2,370,556	5,914,900	5,205,794
Infrastructure	-	-	27,845,015	27,157,528	27,845,015	27,157,528
Vehicles and other equipment	1,961,889	2,174,902	-	-	1,961,889	2,174,902
Construction in progress	2,345,600	1,403,860	3,853,806	1,735,633	6,199,406	3,139,493
Total	<u>\$ 27,306,626</u>	<u>\$ 26,815,193</u>	<u>\$ 59,008,316</u>	<u>\$ 52,138,364</u>	<u>\$ 86,314,942</u>	<u>\$ 78,953,557</u>

Additional information on the County's capital assets can be found in note 5 of the Basic Financial Statements.

Long-term Debt. As of June 30, 2006, Lincoln County had total bonded debt outstanding of \$101,330,001, all of which is debt backed by the full faith and credit of the County.

Lincoln County's Outstanding Debt General Obligation Bonds

Figure 5

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
General obligation bonds	\$ 90,935,156	\$ 66,785,180	\$ 10,394,845	\$ 12,204,820	\$ 101,330,001	\$ 78,990,000

Lincoln County's total debt increased by \$22,340,000 (28.28 percent) during the past fiscal year, primarily due to the issuance of \$28,000,000 general obligation school bonds.

As mentioned in the financial highlights section of this document, Lincoln County maintained its A2 bond rating from Moody's Investor Service, an A rating from Standard and Poor's Corporation, and AA- from Fitch Ratings. This bond rating is a clear indication of the sound financial condition of Lincoln County. This achievement is a primary factor in keeping interest costs low on the County's outstanding debt.

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 Lincoln County is \$342,951,576. The County had \$2,000,000 in school bonds authorized but un-issued at June 30, 2006.

Additional information regarding Lincoln County's long-term debt can be found in note 7 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.

- Although the County unemployment rate for 2006 averaged approximately 5.19%, slightly higher than the state average of 4.88%, we remain lower than some of our surrounding counties who have lost more jobs than Lincoln County.
- Our industrial park was awarded North Carolina Certified Industrial Site status, making it one of 14 such sites across the State.
- In March 2006, *Site Selection* magazine named the Lincolnton area in the County as a Top Ten Micropolitan Area in the nation for its ability to secure new and expanded corporate facility projects.
- Eight industrial expansions were announced during 2006 totaling \$100 million of capital investments and 570 jobs.

- The County's proximity to Charlotte and major transportation corridors continue to make it attractive for development.
- The County has a relative low tax rate of 61 cents which is less than the state average of 65.9 cents.
- Retail sales grew by 11.2% during fiscal year 2006 compared with the same period in year 2005.

Budget Highlights for the Fiscal Year Ending June 30, 2007

Governmental Activities: The County adopted a General Fund budget in the amount of \$87,103,411 for the fiscal year ending June 30, 2007, an increase of \$9,016,314, or 11.5%, from the fiscal year 2006 budget. The majority of the budget increase was to fund increased spending on law enforcement, ambulance service, human services, education, debt service for school bonds, and capital projects. The property tax was unchanged at \$.61 per \$100 valuation.

Business – type Activities: The water and sewer rates in the County continue to remain stable with growth and new customers adequate to cover any increases in expenses. The water system recently completed construction of additional distribution lines. This construction has allowed for the continued expansion and growth of residential and commercial growth in the east along with providing adequate water service for our industrial park in the northern part of the County. Rates for landfill services have remained the same with tipping fees and availability fees adequate to allow the accumulation of funds for future landfill cells and the closure of landfill cells currently in use.

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 Finance Director, Lincoln County, 115 West Main Street, Lincolnton, N.C. 28092.

This page left blank intentionally.