

MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

This section of the County of Lancaster's (County) comprehensive annual financial report presents a narrative overview and analysis of the County's financial performance for the fiscal year ended December 31, 2005. It is recommended that it be read in conjunction with the accompanying basic financial statements and notes to financial statements in order to obtain a thorough understanding of the County's financial condition at December 31, 2005.

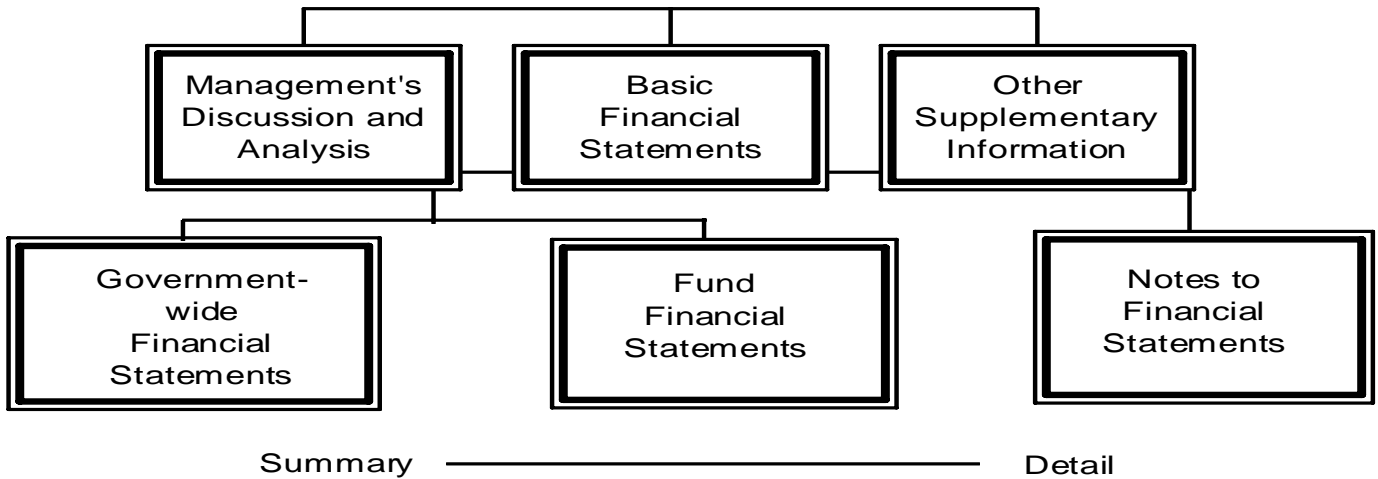
FINANCIAL HIGHLIGHTS

- ◆ The County's real estate property tax rate was 2.962 mills.
- ◆ As of December 31, 2005, Lancaster County had \$20.5 million invested in capital assets, net of related debt pertaining to easements.
- ◆ The County's governmental net assets increased \$5.1 million in 2005, or 51.5%.
- ◆ The County's governmental unrestricted net assets were \$8.1 million at December 31, 2005.
- ◆ The County's bond rating is Aaa/VMIG1
- ◆ At December 31, 2005, the County had \$193.8 million of general obligation debt outstanding. This represents an increase of \$18.1 million, or 10.3%, from the previous year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of this report consists of four parts: management's discussion and analysis, the basic financial statements (including notes to the financial statements), other required supplementary information, and a section that presents combining and individual fund statements and schedules. The basic financial statements present two different views of the County through the use of government-wide statements and fund financial statements. The following diagram shows how the required components of the financial section of this comprehensive annual financial report are arranged and relate to one another.

REQUIRED COMPONENTS OF THE COMPREHENSIVE
ANNUAL FINANCIAL REPORT - FINANCIAL SECTION



The first two basic financial statements are *government-wide financial statements* that provide information about the County's overall financial status, as well as the financial status of the County's component unit. The remaining basic financial statements are *fund financial statements* that focus on major funds of County government, reporting the County's operations in more detail than the government-wide statements. The *fund financial statements* include:

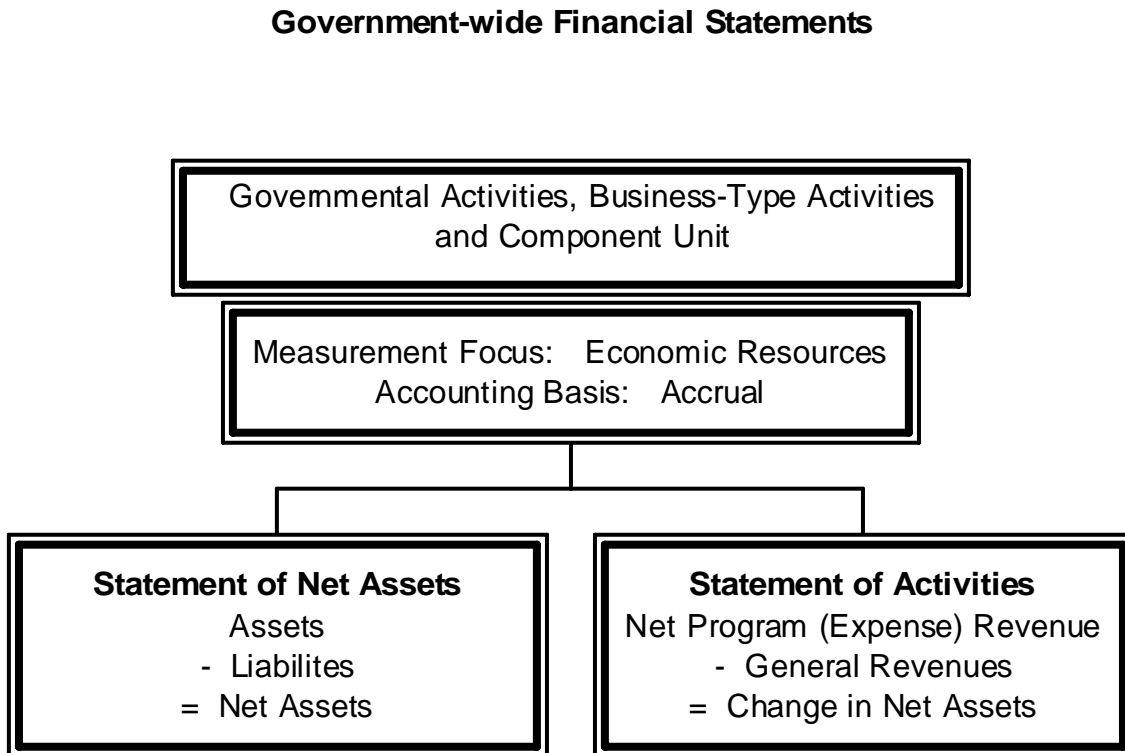
- ◆ *Governmental funds financial statements* which explain how services such as public safety were financed in the short term, as well as what remains for future spending.
- ◆ *Enterprise fund financial statements* offer short-term and long-term financial information about the activities the County operates like a business.
- ◆ *Fiduciary funds financial statements* that reflect activities involving resources that are held by the County as a trustee or agent for parties outside the government. Fiduciary funds are not reflected in the government-wide statements because the resources cannot be used to support the County's programs.

The basic financial statements also include notes to the financial statements that provide additional information essential to a full understanding of the financial data provided in the government-wide and fund financial statements as well as required supplementary information regarding employee pension contributions and the County's budget for the general fund and each major budgeted special revenue fund. In addition to these required elements, a section is included with combining and individual fund statements that provide particulars about non-major governmental funds.

The remainder of this overview explains the structure and contents of the government-wide and fund financial statements.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements report information about the County as a whole and its component unit using accounting methods similar to those used by private-sector companies. The primary features are reflected in the following diagram.



The statement of net assets includes all of the County's assets and liabilities, except fiduciary funds, with the difference between the two reported as net assets. This statement serves a purpose similar to that of the balance sheet of a private-sector business. The statement of activities focuses on how the County's net assets changed during the year. Because it separates program revenue (revenue generated by specific programs through charges for services, grants and contributions) from general revenue (revenue provided by taxes and other sources not tied to a particular program), it shows to what extent each program has to rely on taxes for funding. All changes in net assets are reported using the accrual method of accounting, which requires that revenues be reported when they are earned and expenses be reported when the goods and/or services are received, regardless of when cash is received or paid. Net assets is one way to measure the County's financial health, or position. Over time, increases or decreases in the County's net assets are one indicator of whether the County

financial position is improving or deteriorating. However, other non-financial factors such as changes in the County's real property tax base and general economic conditions must be considered to assess the overall position of the County.

The government-wide financial statements of the County are divided into three categories:

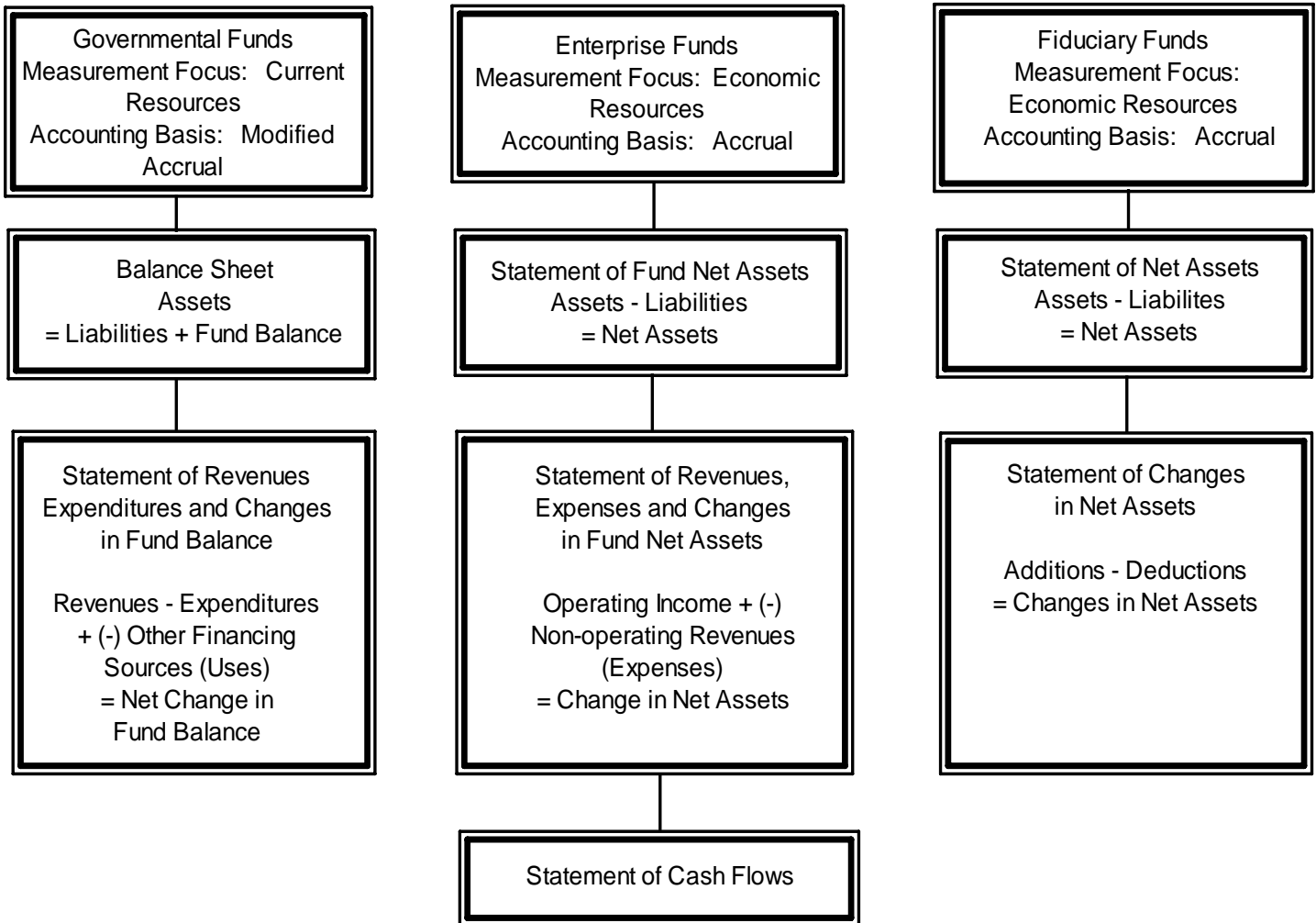
- ◆ *Governmental activities* – Most of the County's basic services are included here, such as public safety, public works, health and welfare and general government administration. Property and other such taxes and state and federal grants are the primary funding source of these activities.
- ◆ *Business-type activities* – The County charges fees to customers to help cover the costs of certain services it provides.
- ◆ *Component Unit* – The County includes one other entity – the Lancaster County Convention Center Authority. *

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the County's funds with an emphasis on major funds, not the County as a whole. Funds are accounting groups that the County uses to keep track of specific sources of funding and spending for particular purposes. State law requires some funds while other funds are established to control and manage resources designated for specific purposes. The following diagram presents the major features of the fund financial statements, including the types of information contained therein.

* See separate report as mentioned in the footnotes.

Fund Financial Statements



The County has three types of funds:

- ◆ *Governmental funds* – Most of the County’s basic services are included in governmental funds, which focus on: (1) the flow in and out of cash and other financial assets that can readily be converted into cash, and; (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps determine the financial resources available in the near future to finance the County’s programs. The County maintains the following major governmental funds: the general fund, Mental Health/Mental Retardation special revenue fund, Children and Youth Services special revenue fund, Agricultural Land Preservation special revenue fund and capital projects fund. The County also maintains seven non-major special revenue funds that are combined into a single aggregated presentation. Because this information does not

encompass the additional long-term focus of the government-wide statements, a detailed reconciliation provides additional information that explains the relationship (or differences) between fund and government-wide financial statements.

- ◆ *Enterprise funds* – Used to report the same functions presented as business-type activities in the government-wide financial statements that provide services for the County’s other programs and activities. The County reports two enterprise funds – the Conestoga View Nursing Home and the 911 operations.
- ◆ *Fiduciary funds* – The County is the trustee, or fiduciary, for its employees’ pension plan. In addition, the County is also responsible for an agency fund, which represents clearing accounts for assets held by the County in its role as custodian until the funds are allocated to the private parties, organizations or government agencies to which they belong. The County is responsible for ensuring that the assets reported in the fund is used for its intended purpose. All of the County’s fiduciary asset and liability balances are reported in the statement of fiduciary net assets. A statement of changes in fiduciary net assets is also presented. All fiduciary activities are excluded from the County’s government-wide financial statements because the County cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE COUNTY AS A WHOLE

The County is presenting its financial statements as required by Governmental Accounting Standards Board Statement No. 34 (GASB Statement No. 34), “Basic Financial Statements – and Management’s Discussion and Analysis (MD&A) – for State and Local Governments.” The statement of Net Assets and the statement of Activities report information about the County as a whole and about its activities to measure the results of the year’s activities.

NET ASSETS:

The County's net assets as of December 31, 2005 and 2004 are presented below:

Table A-1
County Net Assets as of December 31, 2005
(amounts in millions)

	Governmental Activities		Business-Type Activities	
	2005	2004	2005	2004
Capital assets, net*	\$ 155.1	138.5	\$ 1.2	8.3
Other assets	82.0	78.7	.2	3.6
Total assets	237.1	217.2	1.4	11.9
Other liabilities	21.0	23.9	.1	1.2
Long-term liabilities	201.1	183.4	.4	2.5
Total liabilities	222.1	207.3	.5	3.7
Net assets:				
Invested in capital assets, net of related debt*	(4.4)	(4.1)	1.3	8.3
Restricted	11.3	10.4	-	-
Unrestricted	8.1	3.6	(0.4)	(0.1)
Total net assets	\$ 15.0	9.9	\$ 0.9	8.2

Net assets of the County's governmental activities increased by 51.5% to \$15.0 million due to the sale of Conestoga View, the County's nursing home. Of this amount, \$(4.4) million represents the balance of capital related debt in excess of net capital assets, while \$11.3 million is restricted for various purposes. The County has an unrestricted net assets balance of \$8.1 million as of the end of the year.

Net assets of the business-type activities decreased by 89% to \$0.9 million due to the sale of Conestoga View, the County's nursing home. Of this amount, \$1.3 million represents the net balance of long-term capital assets, net of related debt. The unrestricted net assets balance as of the end of the year is \$(0.4) million.

*Capital asset balances include agricultural easements. Prior year amounts reported have been adjusted to reflect this change.

INFRASTRUCTURE ASSETS:

Lancaster County's total assets stand at \$238.5 million as of December 31, 2005. Of this amount, \$156.3 million is accounted for by capital assets, which includes some infrastructure.

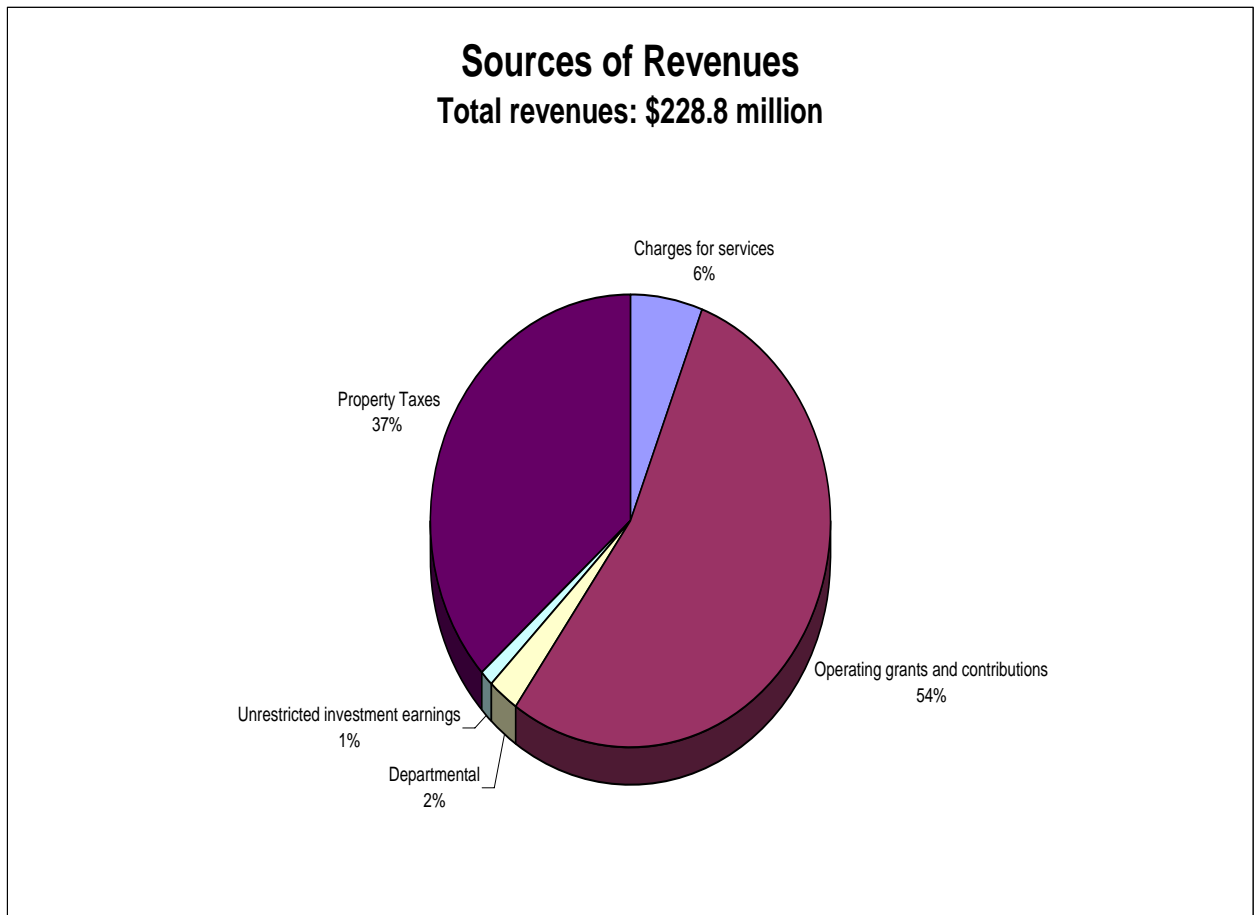
The following table presents the County's changes in net assets for the fiscal year ended December 31, 2005 and 2004:

Table A-2				
County's Changes in Net Assets as of December 31, 2005				
(amounts in millions)				
	Governmental Activities		Business-Type Activities	
	2005	2004	2005	2004
Revenues:				
Program revenues:				
Charges for services	\$ 13.6	10.4	\$ 25.7	36.3
Operating grants and Contributions	123.0	116.3	-	-
General revenues:				
Property taxes	84.0	76.9	-	-
Departmental revenues	5.6	7.5	-	-
Unrestricted investment Earnings	2.6	1.3	-	-
Gain on sale of Capital assets			1.5	
Total revenues	228.8	212.4	27.2	36.3
Expenses:				
General government	52.0	41.8	-	-
Public safety	2.2	1.8	-	-
Roads and bridges	0.2	0.5	-	-
Health, education, and welfare	107.6	100.9	-	-
Judicial	33.7	31.3	-	-
Corrections	17.6	16.8	-	-
Cultural and recreation	2.7	2.8	-	-
Community development	5.8	5.7	-	-
Interest on long-term debt	6.8	5.6	-	-
Conestoga View	-	-	22.0	32.8
911 operations	-	-	7.6	7.3
Total expenses	228.6	207.2	29.6	40.1
Increase in net assets				
before transfers	0.2	5.3	(2.4)	(3.8)
Transfers	4.9	(3.8)	(4.9)	3.8
Change in Net Assets	5.1	1.5	(7.3)	0.0
Net assets - beginning	9.9	8.4	8.2	8.2
Net assets - ending	\$ 15.0	9.9	\$ 0.9	8.2

The increase of \$5.1 million in the governmental activities net assets was mainly the result of the sale of Conestoga View, the County's nursing home. The business-type activities net assets decreased by \$7.3 million mainly due to the sale of Conestoga View to Conestoga View Nursing, L.P. on September 30, 2005 for \$8,500,000, which, after payment of real estate transfer tax associated with the sale, resulted in proceeds from the sale equaling \$8,415,000.

GOVERNMENTAL ACTIVITIES:

The following chart graphically depicts the sources of revenues for the fiscal year ended December 31, 2005:



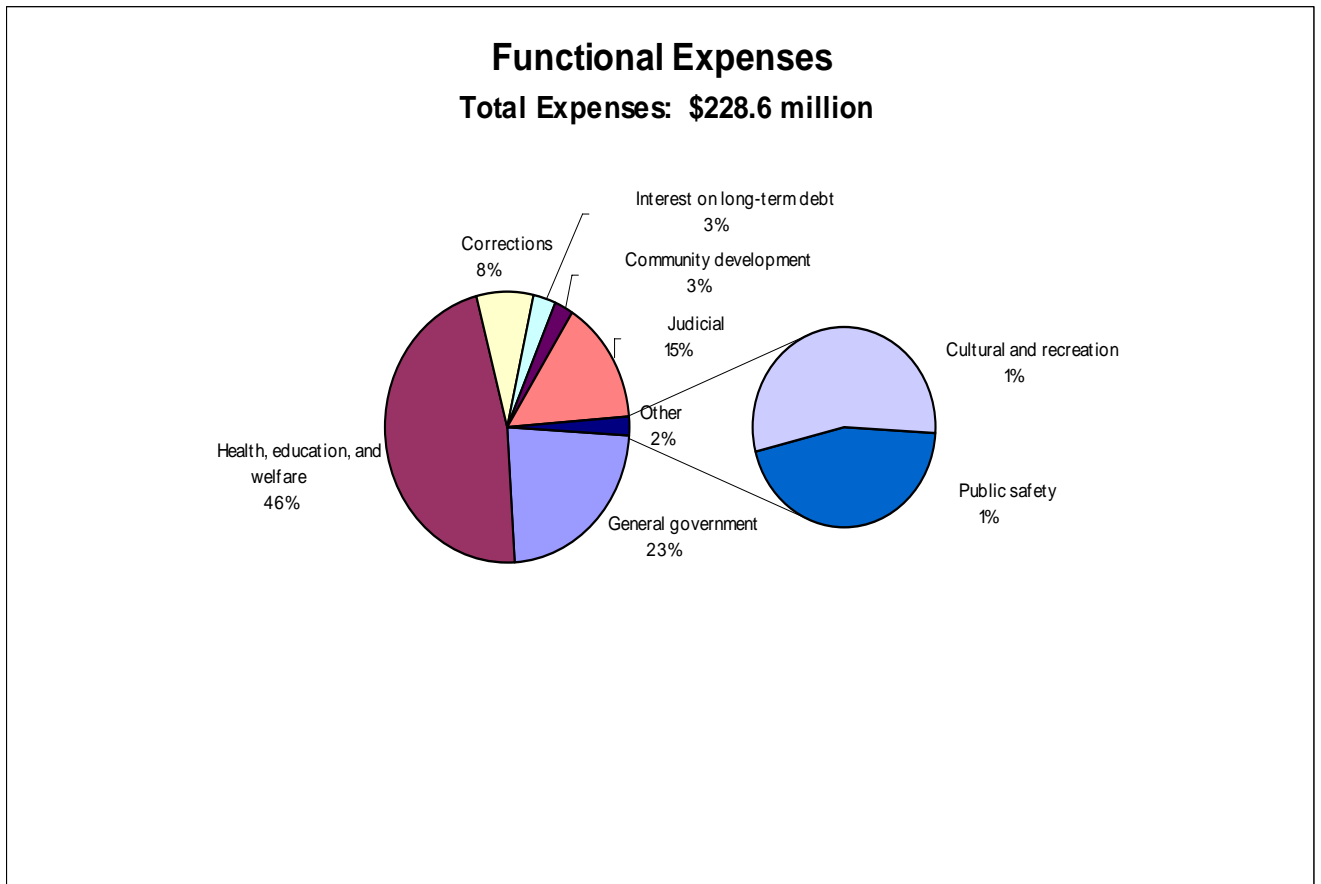
Total government-wide revenues of \$228.8 million were derived primarily from operating grants and contributions, representing 54% of the total. Property taxes made up the second largest source of revenue at 37%, followed by charges for services at 6%, departmental revenue at 2%, and unrestricted investment earnings at 1%.

BUSINESS-TYPE ACTIVITIES:

Total business-type revenues of \$27,202,001 were derived primarily from charges for sales and services and the sale of capital assets, \$23,349,694 coming from Conestoga View, and \$3,852,307 coming from 911 operations.

GOVERNMENTAL ACTIVITIES:

The following chart graphically depicts the functional expenses for the fiscal year ended December 31, 2005:



Total expenses for all programs in 2005 were \$228.6 million. The expenses cover a wide range of services, with the largest being health, education, and welfare at 46%. The second largest program area was general government at 23%, followed by judicial at 15%, corrections at 8%, community development at 3%, interest on long-term debt at 3%, and other (cultural and recreation and public safety) at 2%.

BUSINESS-TYPE ACTIVITIES:

Total expenses in 2005 were \$29,657,086. Conestoga View comprised \$21,980,881 or 74.0% of the total, incurring depreciation expense of \$640,124. The balance of \$21,340,757 was spent on nursing home operations. 911 operations comprised \$7,676,205 or 26.0% of the total, incurring depreciation expense of \$169,259. The balance of \$7,506,946 was spent on public safety operations.

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.

GOVERNMENTAL FUNDS:

The General Fund, Children and Youth Services special revenue fund, Mental Health/Mental Retardation special revenue fund, Agricultural Land Preservation special revenue fund, and Capital Projects fund make up the County's major governmental funds. The focus of the governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County's financing requirements. In particular, unreserved/undesignated fund balance may serve as a useful measure of the County's net resources available for spending at the end of the year.

At December 31, 2005, the General Fund reported a fund balance of \$17.2 million, which was a \$6.2 million or 56.4% increase over the previous year's balance of \$11.0 million. Revenues increased from \$99.7 million to \$108.9 million, a \$9.2 million or 9.2% increase. Property taxes increased by \$8.1 million as a result of the implementation of a countywide reassessment and normal growth in the County's tax base. Expenditures increased from \$84.9 million to \$97.3 million as reported, which was a \$12.4 million or 14.6% increase. Interest and fiscal charges increased by \$1.5 million due to new bond issuances in 2005.

The fund balance in Children and Youth Services special revenue fund decreased to \$1.9 million at December 31, 2005, from \$2.3 million, a \$0.4 million or 17.4% decrease. Revenues decreased from \$34.2 million to \$33.4 million, a decrease of \$0.8 million or 2.3%. Expenditures remained the same at \$40.8 million. All of these decreases were the result of a decrease in the funding for the Temporary Assistance for Needy Families (TANF) program for the period 7/1/05 thru 12/31/05.

The Mental Health/Mental Retardation special revenue fund has no fund balance to report. Revenues in this fund increased to \$58.3 million from \$50.9 million, an increase of \$7.4 million or 14.5%. Expenditures increased from \$51.8 million to \$59.4 million, a \$7.6 million or 14.7% increase. The increases were the result of increased funding within existing grants.

The Agricultural Land Preservation special revenue fund became a major fund in 2003. There is no fund balance to report for the Agricultural Land Preservation special revenue fund as of December 31, 2005.

The fund balance in the Capital Projects fund at December 31, 2005, was \$24.7 million, up from \$23.9 million the previous year. This represents an increase of \$0.8 million or 3.3%. Revenues increased to \$1.1 million from \$0.5 million the previous year, an increase of \$0.6 million or 120.0%. Expenditures increased to \$23.6 million, an increase of \$14.3 million or 153.8% from the amount spent in the previous year of \$9.3 million. The increase in the fund balance is the result of new bonds being issued during the year. The increase in both revenues and expenditures is also the result of the new bond issues.

ENTERPRISE FUNDS:

The County's enterprise funds provide the same type of information found in the government-wide financial statements but in more detail.

Net assets of Conestoga View, the County's nursing home, at the end of the year amounted to \$0 due to the sale of the facility to Conestoga View Nursing, L.P, on September 30, 2005. Net assets for the 911 emergency telephone operations amounted to \$0.9 million. The change in net assets for each fund was (\$7.0) million and (\$0.3) million respectively. Other factors concerning the finances of these two funds mirror those highlighted in the analysis of the County's business-type activities.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the County Board of Commissioners revised the County budget several times. These budget amendments fall into two categories:

- Amendments to appropriations approved shortly after the beginning of the year to reflect budget carryovers from the prior year.
- Increases in appropriations based on supplemental funding sources.

The County's original revenue budget increased from \$116.5 million to \$122.2 million, an increase of \$5.7 million or 4.9%. Actual revenues received totaled \$122.0 million or 99.8% of the final budget. Intergovernmental revenues fell \$9.3 million short of the final budgeted amounts as a result of anticipated grants not being received. This amount was also reflected in decreased grant expenditures.

The County's original operating expenditure budget, excluding transfers, increased from \$113.6 million to \$119.6 million, an increase of \$6.0 million or 5.3%. Actual expenditures were \$105.1 million or 87.9% of the final budget due to cost saving measures implemented in 2005.

Differences between the original general fund budget and the final amended budget were primarily the result of increasing the budget due to an increase in appropriations based on supplemental funding sources.

CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS:

The County's investment in capital assets at December 31, 2005, net of accumulated depreciation, amounted to \$156.3 million. This represented an increase of \$9.5 million or 6.5% over the previous years total of \$146.8 million. Capital assets consist primarily of land and improvements, buildings and improvements, furniture and equipment, assets under capital lease, construction in progress, infrastructure and easements. The following is a summary of capital assets at December 31, 2005 and 2004:

Summary of Capital Assets

	Governmental		Business-Type		Balance at December 31, 2005	Balance at December 31, 2004
	Activities		Activities			
	2005	2004	2005	2004		
Land and land improvements	\$5,853,180	\$5,786,227	\$7,642	\$589,530	\$5,860,822	\$6,375,757
Buildings and improvements	114,857,947	104,461,393	263,513	6,852,203	115,121,460	111,313,596
Furniture and Equipment	23,322,270	22,409,585	2,562,083	14,522,331	25,884,353	36,931,916
Assets under capital lease	1,371,165	1,371,165			1,371,165	1,371,165
Construction in Progress						
Infrastructure	5,938,380	5,480,543			5,938,380	5,480,543
Easements	55,754,711	45,704,954			55,754,711	45,704,954
Less accumulated Deprec/Amort	<u>(52,036,587)</u>	<u>(46,680,887)</u>	<u>(1,580,792)</u>	<u>(13,694,048)</u>	<u>(53,617,379)</u>	<u>(60,374,935)</u>
Total	<u>\$155,061,066</u>	<u>\$138,532,980</u>	<u>\$1,252,446</u>	<u>\$8,270,016</u>	<u>\$156,313,512</u>	<u>\$146,802,996</u>

In the governmental activities, buildings and improvements increased by \$10.4 million. This is the result of the County's purchase of a building at 150 North Queen Street in the city of Lancaster to help solve its long-term space needs.

In the business activities, buildings and improvements decreased by \$6.6 million and furniture and equipment decreased by \$11.9 million. These decreases are the result of the sale of Conestoga View the County's nursing home on September 30, 2005 to Conestoga View Nursing, L.P.

The total capital assets for the governmental activities and business-type activities increased from \$146.8 million to \$156.3 million, an overall increase of \$9.5 million or 6.5%. Of this increase, \$16.5 million occurred within governmental activities and (\$7.0) million occurred within business-type activities.

More detailed information about the County's capital assets can be found in Note 7 of the notes to the financial statements.

LONG-TERM DEBT:

At December 31, 2005, the County had \$193.8 million of general obligation bonds and notes outstanding. This was an increase of \$18.1 million, or 10.3%, from the previous year. The following details activity related to general obligation bonds during 2005:

Summary of General Obligation Bond and Note Activity

Beginning balance at 1/1/2005	\$ 175,662,072
Accretion adjustment	1,245,384
Debt issued	23,775,000
Less principal refunded	0
Less principal payments	<u>(6,880,000)</u>
Ending balance at 12/31/2005	<u>\$ 193,802,456</u>

BOND RATING:

The General Obligation Bond (G.O.B.) Series 2005 issue carries municipal bond insurance policy from Financial Security Assurance Inc. (FSA) which assures payment of the respective principal and interest to the registered owners of the bonds. Moody's Investors Service rated the G.O.B. Series 2005 Aaa/VMIG1 based upon an insurance policy provided by FSA.

More detailed information about the County's long-term debt can be found in Note 9 of the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The key economic factors affecting the County include the following:

- The County's population grew by 3,230 or .7% during 2005. The population has consistently grown within this range over the past decade and the vast majority of the County's residents succeed in finding employment.
- The County's unemployment rate stands at 3.6%, which is a 5.3% decrease over the previous year's rate of 3.8%. This rate compares favorably with the State's rate of 4.7% and the national rate of 4.9%.

These factors were considered in preparing the County's 2006 budget. Amounts available for appropriation in the general fund budget are \$125.0 million, an increase of 6.8% over the final 2005 budget of \$117.0. Real estate taxes were budgeted to increase by \$2.3 million as the result of normal growth in real estate. The real estate property tax rate remained at 2.962 mills for 2006.

Budgeted operating expenditures, excluding transfers, have increased 13.8% to \$130.4 million. The largest increments are increased wages and an increase in the County's debt payments. The County issued \$51,285,000 in new general obligation bonds during 2006.

CONTACTING THE COUNTY'S FINANCIAL MANAGEMENT

This financial report is designed to provide citizens, taxpayers, customers, investors, and creditors with a general overview of the County's finances and to demonstrate the County's accountability. Questions concerning this report or requests for additional information should be directed to:

Lancaster County Controller's Office
County of Lancaster, Pennsylvania
50 North Duke Street
Lancaster, PA 17603