

Management's Discussion and Analysis

As management of the Village of Bald Head Island, North Carolina, we offer readers of the Village of Bald Head Island's financial statements this narrative overview and analysis of the financial activities of the Village of Bald Head Island for the fiscal year ended June 30, 2005. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the Village's financial statements, which follow this narrative.

Financial Highlights

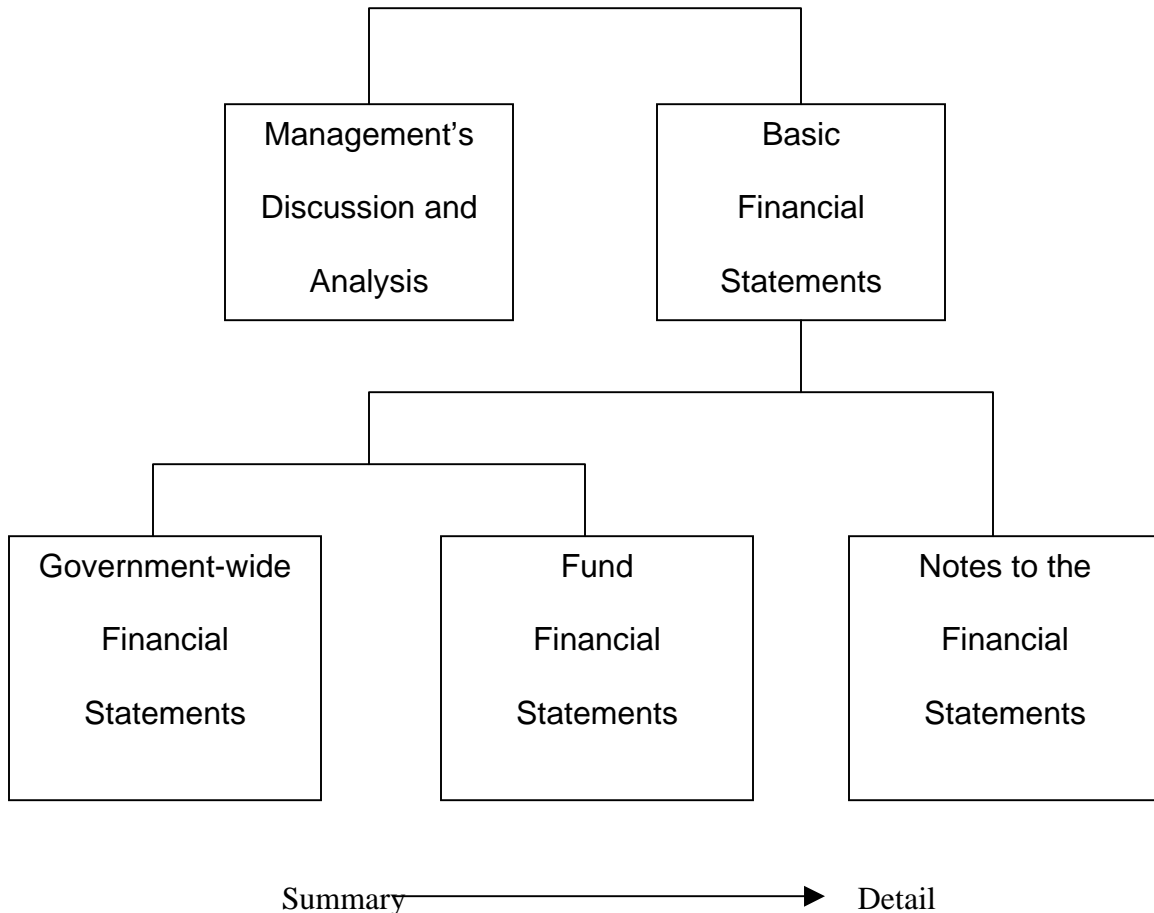
- The assets of the Village of Bald Head Island *exceeded* its liabilities at the close of the fiscal year by \$10,268,327 (*net assets*).
- The government's total net assets *increased* by \$736,040, primarily due to *increases* in tax revenue and investment earnings.
- As of the close of the current fiscal year, the Village of Bald Head Island's governmental funds reported combined ending fund balances of \$6,882,482 an *increase* of \$688,500 in comparison with the prior year. Approximately 94.2 percent of this total amount, or \$6,480,068, 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 \$3,721,360, or 93.7 percent of total general fund expenditures for the fiscal year.
- The Village of Bald Head Island's total debt decreased by \$104,735 during the current fiscal year. The key factor in this decrease was the annual principal payments of outstanding debt.

Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Village of Bald Head Island's basic financial statements. The Village'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 Village 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 the Village of Bald Head Island.

Required Components of Annual Financial Report

Figure 1



Basic Financial Statements

The first two statements (Exhibits 1 and 2) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the Village's financial status.

The next statements (Exhibits 3 through 8) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the Village's government. These statements provide more detail than the government-wide statements. There are two parts to the Fund Financial Statements: 1) the governmental funds statements; and 2) the budgetary comparison statements.

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 Village'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 Village'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 Village's financial status as a whole.

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

The government-wide statements are composed of the Village's governmental activities. The governmental activities include most of the Village's basic services such as public safety, economic and physical development, and general administration. Property taxes and state and charges for services finance most of these activities.

The government-wide financial statements are on Exhibits 1 and 2 of this report.

Fund Financial Statements

The fund financial statements (see Figure 2) provide a more detailed look at the Village'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. The Village of Bald Head Island like all other governmental entities in North Carolina, use fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the Village's budget ordinance. All of the funds of the Village of Bald Head Island are governmental 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 Village'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* that provides a short-term spending 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 Village'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.

The Village of Bald Head Island 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 Village, the management of the Village, and the decisions of the Board about which services to provide and how to pay for them. It also authorizes the Village to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund

demonstrates how well the Village complied with the budget ordinance and whether or not the Village succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement is presented using the same format, language, and classifications as the 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.

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 Exhibit 7 of this report.

Other Information - In addition to the basic financial statements and accompanying notes, this report includes certain required supplementary information concerning the Village of Bald Head Island's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found beginning on exhibit A-1 of this report.

Government-Wide Financial Analysis

The Village of Bald Head Island's Net Assets
Figure 2

	Governmental Activities	
	2005	2004
Current and other assets	\$ 7,322,068	\$ 6,509,266
Capital assets	5,876,640	5,926,976
Total assets	<u>13,198,708</u>	<u>12,436,242</u>
Long-term liabilities outstanding	2,495,486	2,600,221
Other liabilities	434,895	303,734
Total liabilities	<u>2,930,381</u>	<u>2,903,955</u>
Net assets:		
Invested in capital assets, net of related debt	3,381,154	3,414,191
Restricted	-	-
Unrestricted	6,887,173	6,118,096
Total net assets	<u>\$ 10,268,327</u>	<u>\$ 9,532,287</u>

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of the Village of Bald Head Island exceeded liabilities by \$10,268,327 as of June 30, 2005. The Village's net assets *increased* by \$736,040 for the fiscal year ended June

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30, 2005. However, the largest portion (32.9%) reflects the Village'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. The Village of Bald Head Island uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Village of Bald Head Island'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. The remaining balance of \$6,887,173 is unrestricted.

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

- Continued diligence in the collection of property taxes by maintaining a tax collection percentage of 99.92%, which is comparable to the statewide average of 94.78%.
- Increased sales tax revenues of approximately \$7,296 due to economic growth in Brunswick County.
- Increase in accommodations tax of 12% due to economic activity on Bald Head Island.

Village of Bald Head Island Changes in Net Assets
Figure 3

	Governmental Activities	
	2005	2004
Revenues:		
Program revenues:		
Charges for services	\$ 1,026,977	\$ 1,088,539
Operating grants and contributions	145,769	106,634
General revenues:		
Property taxes	4,065,527	3,815,838
Other taxes and licenses	683,574	611,469
Unrestricted investment earnings	152,407	59,984
Miscellaneous revenue	161,141	46,913
Total revenues	<u>6,235,395</u>	<u>5,729,377</u>
Expenses		
General government	803,886	708,262
Public safety	1,800,996	1,442,197
Transportation	373,027	327,261
Environmental protection	607,283	516,983
Economic and physical development	1,723,287	1,263,133
Interest on long-term debt	190,876	158,912
Total expenses	<u>5,499,355</u>	<u>4,416,748</u>
Increase in net assets	736,040	1,312,629
Net assets, July 1	<u>9,532,287</u>	<u>8,219,658</u>
Net assets, June 30	<u>\$ 10,268,327</u>	<u>\$ 9,532,287</u>

Governmental activities. Governmental activities increased the Village's net assets by \$736,040, thereby accounting for 100% of the total growth in the net assets of the Village. Key elements of this increase are as follows:

- Revenues in the general government and in the public safety area were used to construct capital assets.
- Tax revenues remained steady

Financial Analysis of the Village's Funds

As noted earlier, the Village of Bald Head Island uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds. The focus of the Village of Bald Head Island's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the Village of Bald Head Island'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 the Village of Bald Head Island. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$3,721,360, while total fund balance reached \$4,123,774. 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 93.7 percent of total General Fund expenditures.

At June 30, 2005, the governmental funds of Village of Bald Head Island reported a combined fund balance of \$6,882,482, an 11.1 percent increase over last year. Included in this change in fund balance are increases in fund balance in both the General and Capital Projects Funds.

General Fund Budgetary Highlights: During the fiscal year, the Village 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.

Revenues were more than the budgeted amounts primarily because of greater investment earnings and the transfer of infrastructure by developers. Additionally, expenditures were less than budgeted due to diligence of department heads and sound fiscal policy.

Capital Asset and Debt Administration

Capital assets. The Village of Bald Head Island's investment in capital assets for its governmental activities as of June 30, 2005, totals \$5,876,640 (net of accumulated depreciation). These assets include buildings, roads and bridges, land, machinery and equipment, creek access facilities, and vehicles.

Major capital asset transactions during the year include the following additions (there were no significant demolitions or disposals):

- Generator purchase of \$37,370 for public safety in December 2004.
- Three paved roads were received from developers at a value of \$142,000.
- Salvage/disposal of three vehicles.

Village of Bald Head Island's Capital Assets

Figure 4

(net of depreciation)

	Governmental Activities	
	2005	2004
Land	\$ 589,164	\$ 589,164
Buildings	1,142,985	1,169,356
Other improvements	3,157,136	3,233,197
Furniture and equipment	205,283	197,803
Vehicles and motorized equipment	640,072	737,456
Infrastructure	142,000	-
Total	\$ 5,876,640	\$ 5,926,976

Additional information on the Village's capital assets can be found in note III.A.4 of the Basic Financial Statements.

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Long-term Debt. The Village of Bald Head Islands' total debt decreased by \$104,735 (4.0%) during the past fiscal year, primarily due to the annual principal payments.

North Carolina general statutes limit 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 Village of Bald Head Island is \$69,828,523.

Additional information regarding the Village of Bald Head Island's long-term debt can be found in note III.B of this report.

Economic Factors and Next Year's Budgets and Rates

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

- Occupancy rates on rental properties
- Building permits issued

Budget Highlights for the Fiscal Year Ending June 30, 2005

Governmental Activities: Property taxes (benefiting from the economic growth) and revenues from permits and fees are expected to lead the increase in budgeted revenue by 4.41 percent. The Village will use these increases in revenues to finance programs currently in place.

Budgeted expenditures in the General Fund are expected to decrease 3% to \$5,749,072. The largest increments are in employee compensation, including funding compensation and benefits adjustments and the purchase of emergency services vehicles.

Requests for Information

This report is designed to provide an overview of the Village'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 addressed to the Village of Bald Head Island, Office of the Finance Director, P.O. Box 3009, Bald Head Island, NC 28461.