

COUNTY OF LACKAWANNA, PENNSYLVANIA

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2003
&
INDEPENDENT AUDITORS' REPORT
&
REQUIRED SUPPLEMENTARY
INFORMATION**

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INDEPENDENT AUDITORS' REPORT

Commissioners of Lackawanna County
Scranton, Pennsylvania

We have audited the accompanying financial statements of the governmental activities, the business-type activity, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the County of Lackawanna, Pennsylvania, (the "County") as of and for the year ended December 31, 2003, which collectively comprise the County's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Lackawanna County Area Agency on Aging (a Special Revenue fund) and the Lackawanna County Commission On Drug and Alcohol Abuse (a blended component unit) for the year ended December 31, 2003, which represent 1% and 1%, respectively, of total assets and 6% and 3%, respectively, of total revenues of the governmental activities and 21% and 15%, respectively, of total assets and 22% and 10%, respectively, of total revenues of the Health and Human Service Fund. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for the Lackawanna County Area Agency on Aging and the Lackawanna County Commission on Drug and Alcohol Abuse, is based on the reports of the other auditors. In addition, we did not audit the financial statements of the Pension Trust Fund for the year ended December 31, 2003, which represents 96% of the total assets of the Fiduciary Funds. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to amounts included for the Pension Trust Fund, is based on the report of the other auditors. Last, we did not audit the financial statements of the aggregate discretely presented component units (with the exception of the Multi-Purpose Stadium Authority of Lackawanna County and the Lackawanna County Performing Arts Center Authority, which represent 6% and 3%, respectively, of total assets and 8% and 2%, respectively, of total revenues of the discretely presented component units). Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for the discretely presented component units (excluding amounts for the Multi-Purpose Stadium Authority of Lackawanna County and the Lackawanna County Performing Arts Center Authority) is based on the reports of the other auditors.

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 financial statements are free of material misstatement. 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 financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports 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 activity, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the County of Lackawanna, Pennsylvania as of December 31, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the County has implemented a new financial reporting model, as required by the provisions of the Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*, in 2003. Concurrently, the District also implemented Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2004, on our consideration of the County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 4 through 14 and the budgetary comparison information on page 60 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplementary information. However, we did not audit the information and express no opinion on it.



Scranton, Pennsylvania
December 1, 2004

COUNTY OF LACKAWANNA, PENNSYLVANIA

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis ("MD&A") is intended to provide a narrative overview and analysis of the financial activities of the County of Lackawanna, Pennsylvania ("County") for the year ending December 31, 2003. The County's financial performance is discussed and analyzed within the context of the financial statements and the disclosures that follow. This discussion focuses on the County's primary government. Component units, unless otherwise noted, are not included in this discussion.

FINANCIAL HIGHLIGHTS

Overall, the County's liabilities exceeded its assets by \$18,794,924 at December 31, 2003. Governmental activities accounted for \$16,385,241 of this deficit; the business-type activity accounted for the remaining \$2,409,683.

In total, expenses exceeded revenues by \$6,707,485 in 2003. The governmental activities' expenses exceeded its revenues by \$6,908,299 while the business-type activity's revenues exceeded its expenses by \$200,814.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the County's basic financial statements. The County's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains required supplementary information in addition to the basic financial statements.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements are designed to provide readers with a broad overview of the County's finances in a manner similar to a private-sector business. These statements are prepared using the accrual basis of accounting. The focus of these statements is long-term.

The statement of net assets presents information on all of the County's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or deteriorating.

The statement of activities presents information showing how the County's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused compensated absences).

Both of the government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the County include all of the County's activities except for the operation of the Montage Ski Resort, which is considered a business-type activity.

The government-wide financial statements can be found on pages 15-16 of this report.

FUND FINANCIAL STATEMENTS

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of fund financial statements is short-term. Fund financial statements are prepared using the modified accrual basis of accounting. The County uses three types of funds: governmental funds, proprietary funds, and fiduciary funds.

GOVERNMENTAL FUNDS

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the County's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the County's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances for the County's major funds, which are the General Fund, Health and Human Services Fund and the Landfill Trust Fund. All other governmental funds are not considered individually significant and have been aggregated and reported under the caption "Nonmajor".

The County adopts an annual budget for its General, Debt Service and Liquid Fuels Funds. A budgetary comparison statement has been provided to demonstrate compliance with these budgets on page 60.

The basic fund financial statements can be found on pages 17-20 of this report.

PROPRIETARY FUNDS

The County accounts for the operations of the Montage Ski Resort (Enterprise Fund) and its self-funded workers' compensation program (Internal Service Fund) in proprietary funds, which report the same functions presented as business-type activities in the government-wide financial statements. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail.

The Internal Service Fund is included with the governmental activities in the government-wide financial statements since it primarily benefits governmental activities.

The basic proprietary fund financial statements can be found on pages 21-23 of this report.

FIDUCIARY FUNDS

The County accounts for the assets held under trust or in an agent capacity in fiduciary funds. Assets held in trust in the County's retirement plan are accounted for in the Pension Trust Fund. Assets held in a custodial or agent function are accounted for in the Agency Fund.

Fiduciary funds are not reported in the government-wide financial statements since they are not available to support the County's operations.

The basic fiduciary fund financial statements can be found on pages 24-25 of this report.

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 can be to the financial statements can be found on pages 28-59 of this report.

GENERAL FUND BUDGETARY HIGHLIGHTS

The County prepares a budget each year for its General Fund, Debt Service, and Liquid Fuels according to Pennsylvania law. The General Fund's budget is prepared on a cash basis and includes payroll paid for other funds and organizations as expenditures and reimbursements received as revenues.

The General Fund's approved budget for 2003 included \$88,847,286 of revenues and transfers and \$89,061,998 of expenditures. There were no amendments made to the budget in 2003.

Actual revenues received for 2003 were \$79,208,763 or 89% of budget. Significant negative variances were realized in the timing of the receipt of certain federal grants (\$3,000,000), a reduction in prisoners housed on behalf of the federal government (\$1,350,000) and a reduction in expected reimbursements from the County nursing home for payroll and benefits (\$2,200,000).

Actual expenditures paid in 2003 were \$76,415,591 or 86% of budget. The primary reason for the significant positive variance is due to the nonpayment of expenditures (including a \$7,000,000 tax anticipation note) resulting from the County's significant cash flow problems.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The County adopted the financial statement-reporting model required by GASB Statement No. 34 in 2003. Prior year information is unavailable for comparison purposes. A comparative analysis will be provided in future years when such information is available.

CONDENSED STATEMENT OF NET ASSETS

	GOVERNMENTAL <u>ACTIVITIES</u>	BUSINESS-TYPE <u>ACTIVITY</u>	<u>TOTAL</u>
<u>ASSETS</u>			
Current and other assets	\$ 36,263,990	\$ 550,258	\$ 36,814,248
Capital assets	<u>67,899,791</u>	<u>6,238,035</u>	<u>74,137,826</u>
TOTAL	<u>\$104,163,781</u>	<u>\$6,788,293</u>	<u>\$110,952,074</u>
<u>LIABILITIES AND NET DEFICIT</u>			
Current liabilities	\$ 35,566,751	\$ 583,136	\$ 36,149,887
Long-term liabilities:			
Due within one year	3,041,562	1,021,771	4,063,333
Due after one year	<u>81,940,709</u>	<u>7,593,069</u>	<u>89,533,778</u>
Total liabilities	<u>120,549,022</u>	<u>9,197,976</u>	<u>129,746,998</u>
Net deficit:			
Invested in capital assets, net of related debt	(9,454,390)	(2,376,805)	(11,831,195)
Restricted	8,375,610	-	8,375,610
Unrestricted	<u>(15,306,461)</u>	<u>(32,878)</u>	<u>(15,339,339)</u>
Total net deficit	<u>(16,385,241)</u>	<u>(2,409,683)</u>	<u>(18,794,924)</u>
TOTAL	<u>\$104,163,781</u>	<u>\$6,788,293</u>	<u>\$110,952,074</u>

COUNTY OF LACKAWANNA, PENNSYLVANIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)

CONDENSED STATEMENT OF ACTIVITIES

	<u>GOVERNMENTAL ACTIVITIES</u>	<u>BUSINESS-TYPE ACTIVITY</u>	<u>TOTAL</u>
REVENUES:			
Program revenues:			
Charges for services	\$ 33,543,495	\$ 4,287,380	\$ 37,830,875
Operating grants and contributions	39,461,704		39,461,704
Capital grants and contributions	2,120,435		2,120,435
General revenues:			
Taxes levies for general purposes, net	37,699,072		37,699,072
Contributions and other	10,082,440	14,343	10,096,783
Transfers	<u>(1,271,784)</u>	<u>1,271,784</u>	<u>-</u>
Total revenues	<u>121,635,362</u>	<u>5,573,507</u>	<u>127,208,869</u>
EXPENSES:			
General government	13,176,720		13,176,720
Judicial	12,335,032		12,335,032
Corrections	23,239,483		23,239,483
Public works	6,130,015		6,130,015
Human services	51,404,994		51,404,994
Culture and recreation	5,449,802		5,449,802
Conservation and development	4,615,465		4,615,465
Other	4,085,524		4,085,524
Depreciation	4,117,940		4,117,940
Interest	3,988,686		3,988,686
Ski resort	<u>-</u>	<u>5,372,693</u>	<u>5,372,693</u>
Total expenses	<u>128,543,661</u>	<u>5,372,693</u>	<u>133,916,354</u>
CHANGE IN NET ASSETS	(6,908,299)	200,814	(6,707,485)
NET DEFICIT, BEGINNING, AS RESTATED	<u>(9,476,942)</u>	<u>(2,610,497)</u>	<u>(12,087,439)</u>
NET DEFICIT, ENDING	<u>\$ (16,385,241)</u>	<u>\$(2,409,683)</u>	<u>\$ (18,794,924)</u>

COUNTY OF LACKAWANNA, PENNSYLVANIA
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 (UNAUDITED)

GOVERNMENTAL ACTIVITIES

The decrease of \$6,908,299 in 2003 results from the continuing need to fund the operations (mainly debt service) of the Montage Ski Resort (\$1,272,000) and the Multi-Purpose Stadium Authority of Lackawanna County (\$1,514,000) and a general increase in costs with no corresponding increase in revenues. Real estate millage remains unchanged from 2001.

BUSINESS-TYPE ACTIVITY

The increase of \$200,814 in 2003 results only from the transfer of \$1,272,000 from the governmental activities. Otherwise, the operations had a \$1,071,000 loss in 2003. This loss is primarily due to depreciation and amortization of \$978,000.

FINANCIAL ANALYSIS OF THE FUNDS

GENERAL FUND (MAJOR FUND)

The following represents a summary of General Fund revenue, by source, along with changes from 2002.

	<u>2003</u> <u>Amount</u>	<u>2002</u> <u>Amount</u>	<u>Increase</u> <u>(Decrease)</u>	<u>%</u> <u>Change</u>
Taxes	\$ 37,678,891	\$ 36,340,859	\$ 1,338,032	3.7 %
Grants	14,772,563	15,140,910	(368,347)	(2.4)%
County charges and earnings	11,697,685	12,302,619	(604,934)	(4.9)%
Contributions and other	2,393,462	3,492,391	(1,098,929)	(31.5)%
Transfers in	<u>2,573,781</u>	<u>1,532,122</u>	<u>1,041,659</u>	<u>68.0 %</u>
Total	<u>\$ 69,116,382</u>	<u>\$ 68,808,901</u>	<u>\$ 307,481</u>	<u>0.4%</u>

The increase in taxes is due entirely to the increase in assessed value from 2002 to 2003 of approximately \$50,000,000, or 3.7%. The decrease in grants is due to the reduction of approximately \$1,000,000 in child welfare grants from the Commonwealth of Pennsylvania offset by increased grants received for the District Attorney's office. Approximately \$1,000,000 of county charges and earnings was lost due to the federal government discontinuing the housing of prisoners in the County jail. Contributions and other decreased as a result of a number of one-time revenue items in 2002. Transfers in increased in 2003 due to the receipt of \$2,177,000 of funds from the Landfill Trust Fund and a number of one-time transfers in 2002.

COUNTY OF LACKAWANNA, PENNSYLVANIA
 MANAGEMENT'S DISCUSSION AND ANALYSIS
 (UNAUDITED)

The following represents a summary of General Fund expenditures, by function, along with changes from 2002.

	<u>2003 Amount</u>	<u>2002 Amount</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
General government	\$11,040,094	\$10,101,287	\$ 938,807	9.3 %
Judicial	10,057,612	9,935,950	121,662	1.2 %
Corrections	20,918,678	20,102,516	816,162	4.1 %
Public works	4,630,338	4,393,156	237,182	5.4 %
Human services	15,814,856	16,601,986	(787,130)	(4.7)%
Culture and recreation	3,973,470	3,006,463	967,007	32.2 %
Conservation and development	760,328	697,903	62,425	8.9 %
Other	1,415,673	1,759,055	(343,382)	(19.5)%
Transfers out	<u>7,496,587</u>	<u>5,897,503</u>	<u>1,599,084</u>	<u>27.1 %</u>
Total	<u>\$76,107,636</u>	<u>\$72,495,819</u>	<u>\$3,611,817</u>	<u>5.0 %</u>

An overall increase in benefit expenses (primarily health insurance and workers' compensation) of \$1,100,000 affected all functions. In addition, the culture and recreation amount for 2003 includes a \$1,515,000 provision relating to the inability of the Multi-Purpose Stadium Authority of Lackawanna County to repay advances made by the County for debt service. Finally, transfers to the Debt Service Fund increased \$1,700,000 in 2003.

HEALTH AND HUMAN SERVICES FUND (MAJOR FUND)

The Health and Human Services Fund accounts for revenues received for the provision of social services in the County. These services include the nursing home, aging, daycare, drug and alcohol treatment and prevention and medical transportation services.

Total revenues in 2003 were \$33,873,213 versus \$34,319,790 in 2002, a decrease of \$446,577. Decreased revenues of \$1.5 million in the County nursing home offset increased funding for drug and alcohol treatment of \$1 million.

Total expenditures, including transfers, in 2003 were \$34,903,688 versus \$34,489,436 in 2002, an increase of \$414,252. The main reason for the increase was the use of the increased funding for drug and alcohol treatment.

As a result of the decreased revenues and the increased expenditures, the fund balance of the Fund decreased by \$1,030,475 to a net deficit of \$577,326 at December 31, 2003.

LANDFILL TRUST FUND (MAJOR FUND)

The Landfill Trust Fund was established in 2003 with the receipt of \$8.5 million from the termination of trust funds established by the Commonwealth of Pennsylvania relating to the post-closure costs of landfills located in the County. Approximately \$2.4 million of the fund was transferred to other funds for conservation purposes. The fund balance was \$6,271,147 at December 31, 2003.

NONMAJOR GOVERNMENTAL FUNDS

The Debt Service Fund accounts for resources accumulated for the payment of long-term obligations, primarily bonds. A portion of the County's real estate tax levy is used to fund the expenditures of this Fund as well as transfers from other funds for whom the debt was issued. The County did not issue any debt in 2003. The County paid a total of \$6,411,316 in debt service in 2003. Principal payments were \$2,377,981 and the remaining \$4,033,335 was interest on the debt. Fund balance at December 31, 2003 was \$1,961,948 and was used to fund debt service payments due January 1, 2004.

The Capital Projects Fund accounts for resources used in the acquisition, renovation or construction of major capital assets. The Fund received approximately \$2.1 million in 2003 from grants and spent approximately \$4.8 million. Fund balance at December 31, 2003 was \$884,308.

The Other Special Revenue Funds account for liquid fuels, domestic relations, conservation and other miscellaneous activities. There were no significant changes in the Fund from 2002. Fund balance was \$2,104,463 at December 31, 2003.

ENTERPRISE FUND (MAJOR)

The Enterprise Fund accounts for the activity of the Montage Ski Resort. As described above under the caption "Business-Type Activity", the Fund lost approximately \$1,071,000 in 2003 before transfers in. This loss was primarily due to depreciation and amortization of \$978,000.

INTERNAL SERVICE FUND (MAJOR)

The Internal Service Fund accounts for the County's self-insured workers' compensation program. This program is monitored by the Commonwealth of Pennsylvania's Bureau of Labor and Industry, which requires that the County maintain minimum levels of assets in an irrevocable trust for the payment of benefits. The County has chosen to fund only the minimum level required and, as a result, the Fund has a deficit fund balance of \$1,570,319 at December 31, 2003.

PENSION TRUST FUND

The Pension Trust Fund is a fiduciary fund and holds the assets of the County's retirement plan, which amounted to \$92,580,305 at December 31, 2003. This represented an increase of \$18,205,877 or 24% over the 2002 balance. The County had a net pension obligation of approximately \$3.8 million at December 31, 2003 due to the nonpayment of its annual required contribution. This obligation was paid in 2004.

AGENCY FUND

The Agency Fund accounts for assets held by the County in a custodial function for individuals or other governments. The County held approximately \$4.1 million in that role at December 31, 2003.

CAPITAL ASSETS

The County's investment in capital assets at December 31, 2003 is summarized below.

	<u>GOVERN- MENTAL ACTIVITIES</u>	<u>BUSINESS- TYPE ACTIVITY</u>	<u>TOTAL</u>
Land and improvements	\$ 1,321,626	\$ 8,937,605	\$ 10,259,231
Buildings and improvements	60,991,974	3,496,234	64,488,208
Furniture and equipment	24,678,235	7,469,362	32,147,597
Infrastructure	30,759,354	-	30,759,354
Investment in airport	<u>5,308,545</u>	<u>-</u>	<u>5,308,545</u>
 Total	 123,059,734	 19,903,201	 142,962,935
 Less accumulated depreciation	 <u>55,159,943</u>	 <u>13,665,166</u>	 <u>68,825,109</u>
 Net	 <u>\$ 67,899,791</u>	 <u>\$ 6,238,035</u>	 <u>\$ 74,137,826</u>

LONG TERM DEBT

As of December 31, 2003, the County's net general obligation debt was \$88,238,415. This amount is approximately 39% of the County's legal limit of \$225 million. Approximately \$3.5 million of this debt is scheduled for repayment in 2004.

ECONOMIC CONDITION AND OUTLOOK

The County had large deficits in 2003 and 2002 and did not raise taxes in 2004. As a result, the County is projecting a 48% increase in its real estate levy in 2005. The County also issued \$20,145,000 of general obligation bonds on December 1, 2004 to finance the unfunded debt related to the accumulated deficit at December 31, 2003 and the expected deficit in 2004.

The County also issued an aggregate of \$43,590,000 of general obligation bonds on November 15, 2004 to refinance a bond issue, finance capital projects and pay its net pension obligation.

The County is analyzing its operations, both internally and with its component units, to determine what efficiencies may be realized through consolidation.

REQUESTS FOR INFORMATION

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Commissioners, County of Lackawanna, Pennsylvania, 200 Adams Avenue, Scranton, Pennsylvania, 18503.