SHELBY COUNTY OPEB TRUST

ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2008

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WATKINS UIBERALL
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BANKS, FINLEY, WHITE & CO.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Chairman and Members
Shelby County Board of Commissioners and
the Mayor of Shelby County, Tennessee
Memphis, Tennessee

We have audited the accompanying statement of plan net assets of the Shelby County OPEB Trust as of June 30, 2008, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of Shelby County, Tennessee's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Shelby County OPEB Trust as of June 30, 2008, and its changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2008 on our consideration of Shelby County, Tennessee's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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.

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The management's discussion and analysis on pages 3 through 5 is not a required part of the basic financial statements but is 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 the required supplementary information. However, we did not audit the information and express no opinion on it.

The required supplementary information on page 13 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. Such information has been subjected to auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Watkins Uiberall, PLLC
Banks, Finley, White & Co.

Memphis, Tennessee
December 23, 2008

Management's Discussion and Analysis

The management of the Shelby County OPEB Trust (Trust) presents this narrative overview and analysis of the financial activities of the Trust for the fiscal year ended June 30, 2008. This information should be considered in conjunction with the information in the financial statements – including the Notes to financial statements – which follow this section. Since this is the first annual financial report for the Trust no comparative financial statements exist to which comparison might be made.

Accounting principles generally accepted in the United States of America for governmental entities are established by the Governmental Accounting Standards Board (GASB). This Annual Financial Report uses the standards established by GASB's Statement No. 34 *Basic Financial Statement-and Management's Discussion and Analysis-for State and Local Governments* and GASB's Statement No.43 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as well as other authoritative literature known collectively within the accounting profession as "generally accepted accounting principles."

The Shelby County OPEB Trust

The Trust was established as of July 1, 2007 to receive contributions from plan participants and Shelby County Government for certain benefits provided to Shelby County Government employees after active employment ends (postemployment). Former employees receiving long-term disability benefits through the County's program also participate through the Trust. Two types of benefits are provided by this Trust – health care insurance and life insurance. The Trust is managed by a five-member committee of Trustees, consisting of two designated members of the Shelby County Board of Commissioners and three designated administrators of Shelby County Government. Creation of the Trust was significantly influenced by GASB's Statement numbers 43 and 45 that required major changes to the reporting of employer obligations for other postemployment benefits. These statements required that employers' financial statements show more clearly the accumulated liability for such benefits that were already earned by employees.

Financial statements of the Trust show the amounts received (additions) from the County as employer of the plan participants plus amounts received from the participants and the amounts expended (deductions) for benefits and administrative expense. The Trust itself has no obligation to provide funding for the benefits nor does it independently have the capacity to raise funds. Responsibility for determining the benefits and funding them rests with Shelby County Government and the County's Board of Commissioners.

Financial Highlights

The following financial highlights occurred during this first year of the existence of the Trust.

- Shelby County Government made an initial, special, one-time contribution into the Trust of $23,892,191. This contribution came from the County's self-insured employee health insurance fund; the funds were accumulated from contributions in past years.
- Other than the special contribution made by the County, the Trust had additions during the year of $24,333,677 and deductions for benefits and administrative expenses of $11,455,856.
- The first actuarial valuation for the Trust showed that the employer's (County's) annual required contribution was $34,227,000. This amount consists of the accrual for benefits earned by

employees during the current year and amortization of the previously accumulated actuarial liability over a 30 year period.

- At June 30, 2008 the Trust had net assets held in trust for other postemployment benefits of $36,770,012.

More details on these highlights and other information are in the remainder of this discussion and analysis.

Overview of the Financial Report

The Trust is classified as a "fiduciary fund" since the assets are held for the exclusive benefit of former County employees. Financial reports are prepared using the economic resources measurement focus and the accrual basis of accounting. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date. The basic statements included in the financial report are described below.

Statement of Plan Net Assets. This statement presents information on the assets, liabilities and net assets of the Trust at a point in time (the end of the fiscal year). Over time the changes in net assets may serve as a useful indicator of the status of funding other postemployment benefits that have been promised to employees. Net assets are classified as "net assets held in trust for other postemployment benefits."

Statement of Changes in Plan Net Assets. This statement presents information on the additions and deductions to the Trust during the year being reported. Additions include employer contributions to the Trust, employee contributions, net investment income and any other additions that are available to support benefits and expenses. Deductions include the cost of benefits provided during the year and administrative expenses associated with the benefits and Trust administration.

Notes to Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements.

Required Supplementary Information. This section contains two supplementary schedules. The Schedule of Funding Progress shows information from the three most recent actuarial evaluations and permits a determination of the trend of the overall funding status of the Trust. The Schedule of Employer Contributions shows information on the extent to which the employer is providing funding relative to the actuarially determined "annual required contribution." Since only one actuarial evaluation has been performed, the current year's schedules provide data for only one year and trend information is not available.

Financial Analysis and Discussion

Statement of Plan Net Assets.
The Trust had no assets, liabilities or net assets at the beginning of this fiscal year. As of June 30, 2008 this statement showed the following summary amounts:

Total assets	$ 38,097,875
Total liabilities	1,327,863
Net assets held in trust for other postemployment benefits	$ 36,770,012

Assets consist almost entirely of cash and cash equivalents; most of this was held in short term investment funds. There were small amounts receivable for employer contributions and interest income receivable.

Liabilities consist of benefit claims and insurance premiums due to third party administrators or insurance companies for benefits payable as of the reporting date. Plan liabilities do *not* include actuarial accrued liabilities for future benefits that are not due and payable at the reporting date.

Net assets held in trust for other postemployment benefits is the net difference between assets and liabilities and is the amount of the assets available to pay future benefits and administrative expenses. Based on current year amounts, these net assets would cover the actual benefits and expenses payable for over three years.

Statement of Changes in Plan Net Assets.
The Trust showed the following changes in net assets during the year in summary amounts:

Additions	$ 48,225,868
Deductions	11,455,856
Net increase and end of year net assets	$ 36,770,012

Additions include employer contributions of $17,255,202; Shelby County Government charges departments a fringe benefit rate based on 6.5% of the salaries of active employees subject to retirement benefits. Additions also included $1,080,649 from the County's fringe benefit rate on life insurance to distribute the employer's share on an age-adjusted premium basis, $4,061,792 from participant's share of health and life premiums, $1,437,894 from investment income, and $498,140 Medicare reimbursement for drug coverage to Medicare beneficiaries.

Additions also include a one-time special contribution by Shelby County Government of $23,892,191. This contribution came from the County's self-insured health fund from prior contributions into the health insurance plan. This provided an initial amount of funding for the Trust and provides a reasonable amount of working funds to pay current benefits.

Deductions include $10,903,213 for medical claims (including drug benefits), insurance premiums for supplemental coverage to Medicare and drug coverage for participants age 65 and over and life insurance premiums. Also included is $552,643 for administrative cost of third-party administrators and certain other administrative expenses.

A significant factor for consideration and perhaps the major issue from GASB Statement Numbers 43 and 45 is the employer's (Shelby County Government) annual contribution to the Trust compared to the actuarially calculated "annual required contribution" (ARC). The ARC has two components. One component is the estimated amount of benefits and administrative expenses accrued each year based on employee services that year. The second component is the amortization of the "unfunded actuarially accrued liability" (UAAL). This is the present value of the actuarial amount of OPEB benefits earned in previous years by employees at the valuation date. This UAAL is allocated to the ARC over a thirty year period (beginning in FY 2008), but actuarially adjusted for assumptions about increases in the health care rate, the earnings rate on investments, average age at which employees will retire, mortality rates, etc. Starting in FY 2008 the County must report in county-wide and proprietary fund financial statements (but not governmental fund financial statements) any over or under funding of the ARC during the year as an asset (if over funded) or liability (if under funded). From the initial actuarial valuation, the County's ARC is $34,227,000; employer contributions in FY 2008 were $18,335,851 excluding the one-time contribution, or 53.5% of the ARC. Including the one-time contribution the employer contributed 123.4% of the ARC in FY 2008. For the next few years the current contributions should equal or exceed actual benefits payable during the year. However, at some point this will change and increasingly larger employer contributions could be required to pay current year benefits.

Requests for Information

This financial report is designed to provide an overview of the Shelby County OPEB Trust. Questions concerning any of the information provided or requests for additional information should be addressed to Deputy Director of Administration & Finance, Shelby County Government, 160 North Main Street, Memphis, Tennessee 38103.

SHELBY COUNTY OPEB TRUST

Statement of Plan Net Assets
As of June 30, 2008

Assets	
Cash and cash equivalents	$ 38,049,794
Accounts receivable	
Employer contributions receivable	41,299
Accrued interest receivable	6,782
Total assets	38,097,875
Liabilities	
Accounts payable and accrued liabilities	1,327,863
Total liabilities	1,327,863
Net assets held in trust for other postemployment benefits	$ 36,770,012

The notes to financial statements are an integral part of this statement.

SHELBY COUNTY OPEB TRUST

Statement of Changes in Plan Net Assets
For the Year Ended June 30, 2008

Additions	
Contributions	
Employer normal contribution	$ 18,335,851
Employer special contribution	23,892,191
Plan members	4,061,792
Total contributions	46,289,834
Investment income	
Interest	1,437,894
Medicare drug subsidy	498,140
Total additions	48,225,868
Deductions	
Benefits	10,903,213
Administrative expense	552,643
Total deductions	11,455,856
Net increase	36,770,012
Net assets held in trust for other postemployment benefits	
Beginning of year	-0-
End of year	$ 36,770,012

The notes to financial statements are an integral part of this statement.

Note 1 – Summary of significant accounting policies

Reporting entity
The Shelby County OPEB Trust (Trust) is a single-employer defined benefit other postemployment benefit plan that covers retired and disabled employees of Shelby County Government. The Trust was established as of July 1, 2007. The Trust is included in the annual financial report of Shelby County Government as a fiduciary fund. The Trust is managed by a five-member committee of Trustees consisting of two members of the Shelby County Board of Commissioners and three Shelby County Government administrators.

Basis of accounting
The Trust's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

Governmental accounting standards
The financial statements of the Trust have been prepared in accordance with *generally accepted accounting principles* (GAAP) followed in the United States of America. In the U.S. the Governmental Accounting Standards Board (GASB) is the established and recognized standard-setting body for governmental accounting and financial reporting. The financial statements have been prepared consistent with GASB Statement No. 34, Statement No. 43, and other related standards. Private sector accounting standards are established by the Financial Accounting Standards Board (FASB). FASB standards are generally followed for standards issued on or before November 30, 1989 to the extent those standards do not conflict with or contradict GASB pronouncements. In accordance with GASB Statement No. 20, paragraph 7, the Trust has elected *not* to apply FASB standards issued after November 30, 1989.

Deposits and investments
Cash and cash equivalents include cash on hand, demand deposits, savings accounts and short-term investments with maturities of three months or less at the time of purchase. The Trust uses amortized cost on all investments that mature within a year or less at the date of purchase.

Investments are reported at fair value. Investments in equity securities, corporate bonds and issues of U.S. Government and government-backed obligations are valued at the last reported sales price of the fiscal year end. International securities reflect current exchange rates in effect at fiscal year end. Investments in private investment companies consisting of interests in limited partnerships, hedge funds and private real estate limited liability companies are valued at estimated fair value as provided by the investment manager of the investee company. Interest income is recorded on the accrual basis and dividends are recorded on the ex-dividend date. Purchases and sales of securities are recorded on a trade-date basis.

The Trust is authorized to invest in the following:

- Bonds, notes or treasury bills of the United States or other obligations guaranteed as to principal and interest by the Untied States or any of its agencies.
- Certificates of deposit and other evidences of deposit at Tennessee or federally chartered financial institutions. The institutions must be federally insured.
- Obligations of the United States or its agencies under a repurchase agreement.
- Prime commercial paper which is rated at least A2 and issued by a corporation having no record of default of obligations during ten (10) years preceding the investment.
- Prime bankers acceptances which are eligible for purchase by the Federal Reserve System.

- Corporate bonds rated B3 or better by Moody's or B- or better by Standard and Poor's.
- Common or preferred shares of stock in any entity listed on the New York Stock Exchange, American Stock Exchange or NASDAQ Stock Exchange or in American Depository Receipts ("ADRs"). The total market value of ADRs and common or preferred shares of stock, calculated on a monthly basis, shall not exceed 70% of the total market value of the Trust.
- Covered call and put options on individual stocks or indexes, with the prior approval of the Trustees.
- Financial futures contracts on a limited basis for bona fide hedging purposes only with prior approval of the Trustees.
- Real estate including interests in real estate investment trusts, provided, that the total real estate investments of the Trust shall not exceed five percent (5%) of the total value of the Trust.
- International equities, provided that the total international investments, excluding American Depository Receipts, shall not exceed thirty percent (30%) of the total value of the Trust.
- Co-mingled funds, including registered mutual funds and interests in collective trusts.
- Other investments, as approved individually by the Trustees, including securities offered through private placement memoranda.

Receivables and payables
Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan; liabilities for health claims are recognized in the period when the related services are provided. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date.

Net assets
The net assets of the Trust are reported as "Net assets held in trust for other postemployment benefits."

Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and net assets. Estimates also affect the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period.

Note 2 – Plan description

Plan membership
The Trust had the following membership as of July 1, 2007, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	1,680
Long-term disability recipients	120
Active employees	5,028
Total	6,828

A member must be currently receiving a retirement benefit from the Shelby County Retirement System to be eligible for OPEB benefits, except for recipients of long-term disability benefits.

Other postemployment benefits provided by the Trust
The Trust provides two kinds of post employment benefits – health insurance and life insurance. Health insurance is available for an individual or a family; life insurance is available only for the retired employee. Retirees under the age of 65 participate in the same health insurance program as active employees, which is self-insured by Shelby County Government. The self-insured health plan includes prescription drug coverage. Retirees age 65 and older must use Medicare as their primary health insurance. These retirees are provided supplemental health coverage and a Medicare Part D prescription drug plan though

a traditional insurance policy. Retirees are also provided life insurance coverage through a traditional term life insurance policy. The amount of life insurance is equal to the last annual salary before retirement or termination. Benefit provisions may be established or amended by the Shelby County Board of Commissioners, the legislative body of Shelby County Government.

Note 3 – Contributions and reserves

Contributions by plan members and employer contributions by Shelby County Government are established or amended by the Shelby County Board of Commissioners, the legislative body of Shelby County Government. The Trust has no financial obligations beyond the funds made available through Shelby County Government.

Plan members receiving health insurance under the Trust contribute an amount that is higher than the contribution for active employees. Members pay a premium based on their years of service structured in five tiers. Monthly member contributions for retirees under age 65 ranges from $245 to $514 for single coverage and from $489 to $1,061 for family coverage; member premiums for those 65 and older are lower since Medicare is their primary health coverage. For all ages the member premium represents from 30% to 60% of the total cost per member. Members contributed $4.06 million during the year.

Shelby County Government provides the employer contributions to the Trust. The annual required contribution (ARC) from the initial actuarial report was considered in determining the County's actual contribution. The County Commission approved total funding expected to be provided on a continuing basis from all sources that would be over twice the annual disbursements for plan benefits at current levels and over 50% of the employer's annual required contribution.

At creation, the County made a one-time employer contribution to the Trust of $23,892,191. Thus in fiscal year 2008 total employer contributions were 123.4% of the annual required contribution.

The cost of third-party administrators, actuarial reports, audits and similar costs incurred exclusively for the Trust are paid from resources of the Trust. Routine daily administrative costs of administering the benefit plans, accounting services and similar costs are absorbed by Shelby County Government.

The Trust has no legally required reserves.

Note 4 – Funded status and funding progress

An actuarial valuation was prepared as of July 1, 2007, the date the Trust was established. The Trust had no assets at that date. The funded status of the Trust as of the initial actuarial valuation date is as follows (dollar amounts in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
7/1/2007	-0-	$ 319,685	$ 319,685	0%	$ 218,583	146.30%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits; inasmuch as only the initial actuarial valuation has been performed no trend may be discerned from the information at this time.

The accompanying schedule of employer contributions presents trend information about the amounts contributed to the plan by employers in comparison to the ARC, an amount that is actuarially determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years; inasmuch as only the initial actuarial valuation has been performed no trend may be discerned from the information at this time.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Additional information as of the latest actuarial valuation follows:

Valuation date	7/1/2007
Actuarial cost method	Projected unit credit
Amortization method	30 year period beginning July 1, 2007
Remaining amortization period	30 years
Asset valuation method	10-year smoothing method
Actuarial assumptions:	
Investment rate of return	5.25%
Healthcare cost trend rate	2008 – 10.5%; 2009 – 10.0%; 2010 – 9.0%; 2011 – 8.0%; 2012 – 7.0%; 2013 – 6.0%; 2014 and later – 5.0%

Note 5 – Deposits and investments

Cash and cash equivalent deposits at June 30, 2008, at fair value, consist of the following:

Demand deposits	$ 3,049,794
Tennessee Local Government Investment Pool	10,000,000
Short term investment funds (Northern Trust)	25,000,000
Total cash and cash equivalents	$ 38,049,794

The short-term investment in the Collective Short Investment Fund is held by Northern Trust in the name of the Trust. This investment exceeds 5% of the total assets of the Trust.

Custodial credit risk is the risk that the party holding the funds might not be able to pay those funds to the Trust upon maturity or demand. Bank deposits and certificates of deposit are covered by federal depository insurance (FDIC) or are collateralized by a multiple financial institution collateral pool administered by the Treasurer of the State of Tennessee. Funds on deposit with the Tennessee LGIP and Northern Trust are uncollateralized.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration (period of time to maturity or redemption) is the primary measure of the sensitivity of investments to this risk. Both the Tennessee LGIP and Northern Trust short term investment may be withdrawn on any day, resulting in little if any interest rate risk.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The short term nature of investments held at June 30, 2008 result in little credit risk.

SHELBY COUNTY OPEB TRUST

Required Supplementary Information
for the Year Ended June 30, 2008
(Dollar amounts in thousands)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
7/1/2007	-0-	$ 319,685	$ 319,685	0%	$ 218,583	146.30%

Schedule of Employer Contributions

Year Ended June-30	Annual Required Contribution	Percentage Contributed
2008	$ 34,227	123.40%

Notes to Required Supplementary Information

Note 1: The Trust was established as of July 1, 2007 and the only actuarial valuation performed was as of the creation date. Inasmuch as only the initial actuarial valuation has been performed no trend may be discerned from the information at this time.

Note 2: Employer contributions in the year ended June 30, 2008 included a special, one-time contribution of $23,892,191. Without this special contribution the employer would have contributed 53.6% of the annual required contribution.