

### Management's Discussion and Analysis

The management of Shelby County Government (County) presents this narrative overview and analysis of the County's financial activities for the fiscal year ended June 30, 2008. We encourage readers to consider the information presented here in conjunction with information in the transmittal letter found at the front of this report and the basic financial statements, which follow in this section.

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 the GASB's Statement No. 34 *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Shelby County follows all GASB standards in addition to Statement No. 34 as well as other authoritative literature known collectively within the accounting profession as "generally accepted accounting principles."

### Financial Highlights

- At the end of the current fiscal year, unreserved fund balance for the general fund was \$62,563,181, or 18.2% of total general fund expenditures. This was an increase of \$15.4 million or a 32.6% increase.
- Fund balance for the debt service fund increased \$10.3 million to \$73,709,130, which is 44.3% of total expenditures of the debt service fund. The balance is well above our target minimum level of \$4 million and consistent with our plan to provide now for increasing debt service requirements through 2011.
- At July 1, 2007 the County made a one-time payment of \$23,892,191 to the Shelby County OPEB Trust from the Internal Service Fund for employee health insurance. This payment was the initial funding for the newly established OPEB Trust created to accumulate funds for and through which other post-employment benefits of County employees will be paid.
- Total liabilities of Shelby County exceed total assets as of June 30, 2008 by \$948,229,717. The largest contributing factor causing this deficit is the fact that the County issues debt on behalf of entities not a part of the County's primary financial reporting unit and the related assets are not recorded by the County. These entities include the school systems of Shelby County and the City of Memphis, joint ventures with the City of Memphis, and others. Debt for these entities as of June 30, 2008 was \$1,351,430,959.
- Total government-wide net assets decreased \$9.0 million primarily as a result of the payment of \$23.9 million to the OPEB Trust as noted above and depreciation expense, offset by the fund balance increases noted above in the general fund and debt service fund and other changes.

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

## Overview of the Financial Report

The Comprehensive Annual Financial Report includes three major sections – Introductory Section, Financial Section, and Statistical Section. The Introductory Section includes a transmittal letter and general information about the County. The Statistical Section includes financial and non-financial data, some from sources other than financial records and often covering up to ten years. The Financial Section is the major part of the financial report. The Independent Auditor's Report applies only to the Financial Section. This discussion and analysis applies only to the Financial Section.

The Financial Section includes the following statements and schedules:

- Basic Financial Statements
  - Government-wide financial statements
  - Fund financial statements
  - Notes to financial statements
- Required Supplementary Information
- Combining Statements and Individual Fund Statements and Schedules

### BASIC FINANCIAL STATEMENTS

**Government-wide financial statements.** The *government-wide financial statements* are designed to provide a broad overview of Shelby County's finances in a manner similar to a private-sector business. The two government-wide financial statements present highly summarized information for all of County government.

The *statement of net assets* presents information on all of Shelby 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 changes in the financial position of Shelby County. However, because the County issues substantial amounts of debt for capital assets of others, such as the Memphis City Schools, annual decreases in net assets are expected in years when such debt is issued.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying economic event giving rise to the change occurs, *regardless of the timing of related cashflows*. 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 vacation leave).

Both of the government-wide financial statements distinguish functions of Shelby 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 Shelby County include general government, hospital, planning & development, public works, corrections, health services, community services, law enforcement, judicial, other elected officials, education and

interest on debt. The business-type activities of Shelby County consist of codes enforcement, fire services and corrections center.

The government-wide financial statements include not only Shelby County itself - known as the *primary government* - but also four legally separate entities for which Shelby County is financially accountable. These entities are the Shelby County Board of Education, Shelby County Health Care Corporation (The Med), Agricenter International, and the Emergency Communications District. Financial information for these *component units* is reported separately from the financial information presented for the primary government itself. This discussion and analysis is devoted to Shelby County government rather than the component units.

**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. Shelby County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Shelby County can be divided into three categories: 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 a government's near-term financing requirements.

Because the focus of governmental funds is more narrow 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 government'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*.

Shelby County maintains thirteen individual governmental funds. 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 general fund, debt service fund, capital projects fund, education fund, and grants fund, all of which are considered to be major funds. Data from the other eight governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the nonmajor governmental funds combining statements elsewhere in this report.

Proprietary funds. Shelby County maintains two types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. Shelby County uses enterprise funds to account for consolidated codes enforcement, correction center and fire services. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among Shelby County's various functions.

Shelby County uses internal service funds to account for its central services, group health, tort liability and employer insurance funds. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements. Enterprise funds and internal service funds are each combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the enterprise funds and internal service funds are provided in the form of *combining statements* elsewhere in this report.

*Fiduciary funds.* Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support Shelby County's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The Shelby County Retirement System is the major fiduciary fund, but also includes the Shelby County OPEB Trust and agency funds.

*Component units combining statements.* Component units are not "funds" of Shelby County as the primary government. However, the government-wide financial statements include one column for all component units as discussed above. In order to provide details on each component unit, a combining statement of net assets and a combining statement of activities are included in the fund financial statements section of the basic financial statements.

**Differences between government-wide and fund financial statements.** The government-wide financial statements are much more aggregated and summarized than the fund financial statements. The government-wide statement of net assets includes capital assets and long-term debt, whereas the fund balance sheets include neither. The government-wide statement of activities does not report the issuance or repayment of long-term debt during the year and reports depreciation expense but not amounts expended for capital assets during the year. The fund statement of revenues, expenditures and changes in fund balances includes as other financing sources the amount of long-term debt incurred during the year and as expenditures the amount of principal repaid. This statement also includes amounts expended for capital assets but not depreciation. These are some of the most common, significant differences but there are others. Following the fund balance sheet and the fund statement of revenues, expenditures and changes in fund balances is a reconciliation of those statements to the government-wide statement of net assets and the statement of activities.

**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. "Notes" is the traditional term applied to this information; however the term is misleading in that the notes can vary in length from one paragraph to several pages.

**REQUIRED SUPPLEMENTARY INFORMATION**

This section contains other information that financial reporting standards specify should be included under this caption. Supplementary information is presented for the Shelby County Retirement System and the Shelby County OPEB Trust. Shelby County is also required to present information on budgetary compliance. Budgetary comparison schedules are presented for the general fund and other "major" special revenue funds (the education fund and the grants fund) to demonstrate compliance with their budget. Other budgetary comparison schedules not fitting the criteria defined for this section are presented under "Combining Statements and Individual Fund Statements and Schedules."

**COMBINING STATEMENTS AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES**

Combining fund statements for the non-major special revenue funds, non-major enterprise funds and internal service funds are included in this section of the report. Supplemental schedules include general fund and grants fund budgetary comparisons by department, detail of constitutional officers' activities and schedules of debt by debt issue.

**Government-wide Financial Analysis  
(Reporting the County as a Whole)**

**FINANCIAL POSITION**

Table 1 shows a condensed version of the Statement of Net Assets (see the government-wide financial statements for the full version as of June 30, 2008). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2008 and as of June 30, 2007.

Property taxes receivable is by far the largest portion of Shelby County's assets (44.8% at June 30, 2008 and 43.1% at June 30, 2007). The June 30, 2008 property taxes receivable includes \$715.2 million, offset by an equal deferred revenue amount in other liabilities, which became a property lien on January 1, 2008 but are levied for next fiscal year's operations. The similar amount at June 30, 2007 was \$698.1 million. Total assets decreased by \$3.7 million. Increases in taxes receivable (\$28.1 million) were offset by decreases in cash and cash equivalents and investments and capital assets (\$7.7 million) as the result of depreciation exceeding additions, plus other changes.

Liabilities increased slightly by \$5.3 million during the year. This increase was due to a decrease of \$88.9 million in long-term liabilities and increases of \$94.2 million in other liabilities. Most of the increases were in amounts due to other governments and component units and notes payable for short-term borrowings to finance capital improvement projects (\$37.3 million).

Table 1  
Condensed Statement of Net Assets  
As of June 30, 2008 and June 30, 2007

	June 30, 2008	June 30, 2007 (Restated)	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 773,358,601	\$ 745,228,799	\$ 28,129,802
Current and other assets	346,945,673	369,310,661	(22,364,988)
Capital assets	561,814,679	568,980,051	(7,165,372)
Total assets	1,682,118,953	1,683,519,511	(1,400,558)
Long-term liabilities	1,780,307,893	1,869,575,410	(89,267,517)
Other liabilities	885,036,372	791,662,585	93,373,787
Total liabilities	2,665,344,265	2,661,237,995	4,106,270
Invested in capital, net of related debt	180,537,007	157,206,332	23,330,675
Restricted	104,459,938	91,417,704	13,042,234
Unrestricted	(1,268,222,257)	(1,226,342,520)	(41,879,737)
Total net assets	(983,225,312)	(977,718,484)	(5,506,828)
<u>Business-Type Activities</u>			
Current and other assets	15,765,609	17,519,795	(1,754,186)
Capital assets	27,368,366	27,908,007	(539,641)
Total assets	43,133,975	45,427,802	(2,293,827)
Long-term liabilities	5,938,893	5,608,117	330,776
Other liabilities	2,199,487	1,375,514	823,973
Total liabilities	8,138,380	6,983,631	1,154,749
Invested in capital, net of related debt	26,328,481	26,737,011	(408,530)
Unrestricted	8,667,114	11,707,160	(3,040,046)
Total net assets	34,995,595	38,444,171	(3,448,576)
<u>Total Primary Government</u>			
Property taxes receivable	773,358,601	745,228,799	28,129,802
Current and other assets	362,711,282	386,830,456	(24,119,174)
Capital assets	589,183,045	596,888,058	(7,705,013)
Total assets	1,725,252,928	1,728,947,313	(3,694,385)
Long-term liabilities	1,786,246,786	1,875,183,527	(88,936,741)
Other liabilities	887,235,859	793,038,099	94,197,760
Total liabilities	2,673,482,645	2,668,221,626	5,261,019
Invested in capital, net of related debt	206,865,488	183,943,343	22,922,145
Restricted	104,459,938	91,417,704	13,042,234
Unrestricted	(1,259,555,143)	(1,214,635,360)	(44,919,783)
Total net assets	\$ (948,229,717)	\$ (939,274,313)	\$ (8,955,404)

“Net assets” are the difference between assets and liabilities and, in a general sense, may be considered the recorded financial “net worth” of the County. The most obvious concern that can be noted about net assets is the large negative net asset amount. The major factor causing this negative net asset amount relates to debt issued for capital assets (buildings, roads, etc.) where the capital asset values are *not* recorded in the County’s financial records but the debt *is* on the

County’s records. Some of this debt has been issued to provide capital assets to component units of the County, including the Shelby County Board of Education and the Shelby County Health Care Corporation (The Med). These component units report the capital assets but not the debt. Other debt is issued for entities not a part of the County reporting entity, including the Memphis City Schools Board of Education and the Convention Center. As a result of reporting the debt liabilities without reporting the assets acquired with the proceeds of the debt, a negative net asset amount is reported in the County’s statement of net assets.

The following long-term debt and notes payable are reported by the County for which related capital assets are not recorded by Shelby County:

	June 30, 2008	June 30, 2007
Shelby County and City of Memphis schools	\$ 1,141,454,294	\$ 1,155,445,388
Shelby County Health Care Corp. (component unit)	88,910,874	96,863,696
Convention Center (joint venture)	65,054,070	73,062,007
Other	56,011,721	58,872,608
Total	\$ 1,351,430,959	\$ 1,384,243,699

Shelby County, the component units, and other entities (such as Memphis City Schools) use these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Shelby County’s investment in its capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

The County’s total net assets decreased by \$9.0 million. The significant reasons for this decrease can be generally understood from information in the sections below about “Changes in Net Assets” and the “Financial Analysis of the Government’s Funds.” Changes in net assets are discussed below.

**CHANGES IN NET ASSETS – REVENUES, EXPENSES AND TRANSFERS**

Table 2 summarizes the financial activity for the County as a whole for the fiscal year ending June 30, 2008, with comparative amounts for the fiscal year ending June 30, 2007.

For governmental activities, program revenues are those revenues generated by the department or program as a result of the activities engaged in by the department or program. General revenues are those revenues not generated through the activities of the County; property taxes produce the largest amount of general revenues. Program revenues increased by \$10.9 million; there was a \$15.4 million increase in operating grants and decreases in charges for services and capital grants and contributions. General revenues increased \$27.1 million, or 3.3%; of this, property tax increased \$22.5 million and investment earnings increased \$3.0 million. Overall revenues increased \$38.0 million or 3.6% during the year.

Table 2  
Shelby County Change in Net Assets  
Fiscal Years Ended June 30, 2008 and 2007

	FY 2008	FY 2007 (Note page 21)	Change
<b>Governmental activities:</b>			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 88,324,051	\$ 91,277,341	\$ (2,953,290)
Operating grants and contributions	136,552,118	121,125,431	15,426,687
Capital grants and contributions	1,914,603	3,440,619	(1,526,016)
Total program revenues	<u>226,790,772</u>	<u>215,843,391</u>	<u>10,947,381</u>
General revenues:			
Property taxes	703,098,494	680,615,376	22,483,118
Other taxes	124,926,766	124,690,522	236,244
Other	28,930,625	24,575,622	4,355,003
Total general revenues	<u>856,955,885</u>	<u>829,881,520</u>	<u>27,074,365</u>
Total revenues-governmental activities	<u>1,083,746,657</u>	<u>1,045,724,911</u>	<u>38,021,746</u>
<u>Expenses:</u>			
General government	54,298,799	48,815,450	5,483,349
Hospital	27,600,000	27,566,667	33,333
Planning & Development	5,593,676	6,133,345	(539,669)
Public Works	50,146,007	52,071,835	(1,925,828)
Corrections	1,461,598	928,659	532,939
Health Services	68,120,302	57,842,725	10,277,577
Community Services	45,804,646	42,808,278	2,996,368
Law Enforcement	146,041,090	138,231,040	7,810,050
Judicial	85,085,401	74,919,142	10,166,259
Other Elected Officials	27,522,711	25,988,417	1,534,294
Education	498,893,788	451,071,817	47,821,971
Interest on debt	71,866,481	87,802,538	(15,936,057)
Total expenses-governmental activities	<u>1,082,434,499</u>	<u>1,014,179,913</u>	<u>68,254,586</u>
Increase (decrease) in net assets before transfers	1,312,158	31,544,998	(30,232,840)
Transfers	<u>(6,818,986)</u>	<u>(7,270,833)</u>	<u>451,847</u>
Increase (decrease) in net assets	(5,506,828)	24,274,165	(29,780,993)
Net assets - beginning of year	<u>(977,718,484)</u>	<u>(1,001,992,649)</u>	<u>24,274,165</u>
Net assets - end of year	<u>\$ (983,225,312)</u>	<u>\$ (977,718,484)</u>	<u>\$ (5,506,828)</u>

Total expenses for the year in governmental activities increased \$68.3 million (6.7%). Of this, \$23.9 million was paid to the newly-established OPEB Trust; this expense was allocated across all the functional areas. A net increase of \$47.8 million was provided for education, mostly for

capital projects. Significant increases were also provided for health services, law enforcement and judicial.

<b>Business-type activities:</b>	FY 2008	FY 2007 (Note below)	Change
<u>Revenues:</u>			
Operating revenues:			
Charges for services	\$ 69,914,088	\$ 65,377,640	\$ 4,536,448
Operating grants and contributions	75,000	49,050	25,950
Total operating revenues	69,989,088	65,426,690	4,562,398
Non-operating revenues	317,151	525,358	(208,207)
Total revenues	70,306,239	65,952,048	4,354,191
<u>Expenses:</u>			
Operating expenses	80,313,815	70,343,705	9,970,110
Non-operating expenses and losses	259,986	782,010	(522,024)
Total expenses	80,573,801	71,125,715	9,448,086
Increase (decrease) in net assets before transfers	(10,267,562)	(5,173,667)	(5,093,895)
<u>Transfers</u>	6,818,986	7,270,833	(451,847)
Increase (decrease) in net assets	(3,448,576)	2,097,166	(5,545,742)
Net assets - beginning of year	38,444,171	36,347,005	2,097,166
Net assets - end of year	34,995,595	38,444,171	(3,448,576)
<b>Total primary government:</b>			
Increase (decrease) in net assets	(8,955,404)	26,371,331	(35,326,735)
Net assets - beginning of year	(939,274,313)	(965,645,644)	26,371,331
Net assets - end of year	<u>\$(948,229,717)</u>	<u>\$(939,274,313)</u>	<u>\$ (8,955,404)</u>

Note: As explained in the Notes to Financial Statements in a following section, in Note IV (Q), prior period net assets were restated as of June 30, 2007. To facilitate the comparisons above and to permit fund balances to add properly on these comparative schedules, the same prior period adjustment amount was applied to the FY 2007 beginning balances.

In business-type activities, total revenues increased by \$4.4 million. Of this increase, \$2.2 million was in corrections center reimbursement for housing State inmates and \$3.2 million in fire services from increase in fire fees. Consolidated codes had a decrease of \$1.0 million in fee collections due to lower construction activity. Overall expenses increased by \$9.4 million, or 13.3%. Expenses increased by approximately \$1.9 million dollars in the corrections center due to an increased number of inmates and \$4.5 million for fire services due to increased ambulance service being provided. All activities had increased charges due to required contributions to the newly-established OPEB Trust.

#### CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during fiscal year 2008 was a decrease in net assets of approximately \$9.0 million. The County's governmental activities operated with a decrease in net assets of approximately \$5.5 million.

The business-type activities had a net decrease of \$3.4 million. Before the allocation of the contribution to the OPEB Trust made from an Internal Service Fund was allocated to all functions and the business-type activities, Consolidated Codes had a loss for the year of \$3.1 million.

### Financial Analysis of the Government's Funds

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

**Governmental funds.** The focus of Shelby County's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable resources*. Such information is useful in assessing Shelby County's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, Shelby County's governmental funds reported a combined ending fund balance of \$149,273,359. The components of the balances are:

	June 30, 2008	June 30, 2007
General Fund-reserved/designated	\$ 2,940,960	\$ 4,119,786
General Fund-unreserved	62,563,181	47,178,094
Debt Service Fund	73,709,130	63,401,912
Special Revenue Funds	33,233,724	28,015,792
Total, except Capital Projects Fund	172,446,995	142,715,584
Capital Projects Fund	(23,173,636)	97,730,872
Total all governmental funds	<u>\$ 149,273,359</u>	<u>\$ 240,446,456</u>

There was a \$29.7 million increase in fund balance excluding capital projects. Of this increase \$15.4 million was in the unreserved balance in general funds, \$10.3 million was in the debt service fund and \$5.2 million was in the special revenue funds. There was also a decrease of \$120.9 million in the capital projects fund. Each of these changes is discussed below.

The general fund operated with a net increase in fund balance of \$14.2 million, resulting primarily from increased tax revenues, with increased expenditures being offset mostly by decreases in transfers out. The general fund unreserved amount is available for spending at the government's discretion. The remainder of fund balance has been committed to liquidate contracts and purchase orders of the prior period and for advances to the fire services fund.

The general fund is the chief operating fund of Shelby County. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 18.2 percent of total general fund expenditures, while total fund balance represents 19.0 percent of that same amount. General fund revenues were \$14.2 million (4.1%) above the prior year, which resulted primarily from

increased taxes offset by some decrease in other revenues. Expenditures were \$17.7 million more (5.4%) than the prior year and net transfers out were \$11.7 million less. Before the beginning of FY 2006 management committed to maintaining an unreserved fund balance of the general fund of at least 12.5% of general fund expenditures.

The debt service fund has a total fund balance of \$73.7 million to be used for the payment of debt service. The net increase in fund balance during the current year was \$10.3 million. This increase was planned to somewhat smooth out the revenue requirements in future years as debt service requirements reach a peak projected amount in 2011.

The fund balance of the capital projects fund decreased from \$97.7 million to a deficit of \$23.2 million, a decrease of \$120.9 million. This was primarily the result of expending \$143.1 million from proceeds of long-term debt issued in prior years and short-term debt issued during the current year. The fund had \$37.3 million of outstanding short-term debt as of June 30, 2008.

All special revenue fund balances are used for the specific purposes designated by the provider of the funds or the legislation establishing the fees and charges that generate the revenue. Total fund balances of these funds increased to \$33.2 million at June 30, 2008 compared to \$28.0 million at June 30, 2007. Significant balances include \$2.5 million in the grants fund, \$2.7 million in the health services restricted fees fund, \$8.4 million in the roads and bridges fund, \$12.0 million in the hotel/motel tax fund and \$5.4 million in the Sheriff narcotics fund.

**Proprietary funds.** Shelby County's proprietary funds report financial information on the same basis as the government-wide financial statements (full accrual accounting based on the economic substance of transactions), but in more detail. Proprietary funds consist of two types of funds: business-type activities - enterprise funds and governmental activities - internal service funds.

The County has three business-type activities; these are essentially self-supporting activities. Two of the activities have historically been able to support themselves; these are the consolidated codes enforcement fund and the fire services fund. However, starting in FY 2005 a management decision was made to spend down the net asset balance in the consolidated codes enforcement fund. During this fiscal year the net asset balance decreased by \$3.1 million to a balance of \$2.4 million, of which only \$301,604 is unrestricted. The fire services fund operates entirely on user fees; the net asset balance decreased slightly during this fiscal year by \$130,462 to a balance of \$4.8 million, of which \$2.9 million is unrestricted. The corrections center receives reimbursement from the State of Tennessee for housing State prisoners, which accounts for approximately 80% of the prison population. The general fund provides the remaining cost, excluding depreciation. The Center operated with an increase of \$3.4 million in net assets to a balance of \$31.7 million, of which \$9.3 million is unrestricted.

Total net assets of the enterprise funds increased by \$427,034 during the year. This net increase resulted from an increase in corrections center revenue, offset by the planned use of fund balance in the consolidated codes enforcement fund. The enterprise funds had total net assets at year-end

of \$38.9 million, of which \$12.5 million was unrestricted. Unrestricted net assets increased 56.8% or \$4.5 million.

The County has four internal service funds. These funds are reported using full accrual accounting. *For the government-wide financial statements, these funds are combined with governmental activities.* At June 30, 2008 these funds combined had net assets of \$6,424,825, a decrease of \$23,991,961 over the restated balance of \$30,416,786 from the prior year. Most of the decrease was the result of paying \$23,892,191 from the health insurance fund to the newly established Shelby County OPEB Trust, a fiduciary fund. Other than the payment to the OPEB Trust, the health insurance fund had a decrease of \$2.4 million in net assets and the employer insurance fund had an increase of \$2.0 million. At year-end the health insurance fund had net assets of \$2.6 million and the employer insurance fund had net assets of \$2.5 million.

**Fiduciary funds.** Shelby County reports three fiduciary funds. The largest is the Shelby County Retirement System. The funds in this trust are available only for retirement benefits of current and retired County employees. The accumulated funds in the retirement system slightly exceed the currently calculated actuarial liability, meaning the system is fully funded. The County provides funding as required each year for the increased liability for benefits being earned by current employees.

The Shelby County OPEB Trust was created as of July 1, 2007 to accumulate funds and pay other post-employment benefits to terminated County employees. The Trust received an initial contribution of \$23,892,191 from the County's health insurance fund.

The County also maintains agency funds for a number of the County's elected "constitutional officers" (those officials designated by the State's constitution). These funds do not belong to the County, but are funds held for others. There are no "fund balances" for agency funds.

### Governmental Fund Budgetary Highlights

Differences between the original budget and the final amended budget and between the final budget and actual results for the general fund can be briefly summarized as follows:

- The revenue budget was increased slightly during the year by \$217,427, or less than 1/10<sup>th</sup> of one percent from the original budget. The small increases were in local revenues and elected officials' fines and fees.
- Actual revenues exceeded the revised budget estimate by \$7.8 million, or 2.2%. Actual property taxes were \$4.2 million more than budgeted, or 2.1%. Other local taxes were \$1.8 million over the budget: this was attributed to excess business taxes over the budget offset by some lower other taxes. State revenues exceeded budget by \$1.8 million, reflecting favorable collections of state income taxes; the state income taxes were probably under-budgeted. Elected officials' fines and fees were \$1.1 million over the budget, offset by an equal amount of other revenue below the amount budgeted.
- The overall expenditure budget was increased during the year by \$1.6 million, or about five-tenths of one percent. Increases were necessary to fund a new department for the Land Bank and increased personnel for the Juvenile Court.

- Actual expenditures were \$11.3 million below the amended budget, a savings of about 3.2%. Most of the savings were attributed to reduced expenditures in salaries and benefits (\$7.9 million), with over one-half of this in the Sheriff's Office. Operating expenses were reduced by the balance, with the savings spread across the County.
- The budget for net transfers out was decreased by \$0.8 million, primarily reflecting additional transfers in from several departments.

### Capital Asset and Debt Administration

**Capital Assets.** Shelby County Government's investment in capital assets for its governmental and business type activities as of June 30, 2008 amounts to \$589.2 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and system improvements, machinery and equipment, park facilities, roads and other infrastructure. Additions for the year were \$21.7 million, depreciation was \$28.85 million and disposals were \$0.6 million, for a net decrease of \$7.7 million. Construction in progress as of the end of the current fiscal year was \$13.2 million.

Additional information on Shelby County Government's capital assets can be found in note IV (E) of the Notes to Financial Statements of this report.

Major capital asset events during the current fiscal year included the following:

- Although not recorded as assets of the County, during FY 2008 the County provided capital improvement funding of \$133.5 million to the Memphis and Shelby County school systems.
- Roadway improvements and drainage improvements continued within the County with expenditures of approximately \$4.0 million.
- Renovation work continued at the Criminal Justice Complex, with expenditures of approximately \$0.4 million.
- Expenditures for new roofing at the Corrections Center were approximately \$0.8 million.

**Long-term Debt.** At June 30, 2008 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,735,025,160 which represented approximately 9.8% of assessed value. The County's bonds, loans and notes payable decreased by approximately \$47 million (2.6%) during the year. Debt, generally, may be issued without regard to any limit on indebtedness. The ad valorem tax levy is also without legal limit.

The County uses notes payable programs to initially finance capital projects. This allows the County to borrow only as the proceeds are actually needed and to take advantage of lower short-term interest rates. Annually, the County adopts a five-year capital projects plan. Based on this plan for the current year and capital projects cash flow projections, a notes payable program is established with a maximum borrowing amount. Borrowing occurs as needed for up to two years. After completion of each program, the notes payable are converted to bonds payable to be repaid within 25 years. On February 11, 2008 the County authorized the issuance of \$120 million of extendible municipal commercial paper ("EMCP").

An agreement was signed in 2005 with the Shelby County and City of Memphis Schools boards of education to provide \$100 million to be divided equally between the two school systems to provide a new high school for the County schools and to provide funding for renovations for the City of Memphis schools. In addition, this agreement provides for capital funding to the schools of \$60 million per year for fiscal years 2007, 2008 and 2009, to be divided based on average daily attendance.

The County maintains ratings from Moody's Investors Service ("Moody's"), Standard & Poor's Corporation ("Standard & Poor's") and Fitch IBCA, Inc. ("Fitch") on its previously issued general obligation bonds not secured by letter of credit as follows:

Moody's	Standard & Poor's	Fitch IBCA, Inc.
Aa2	AA+	AA

Moody's issues ratings from Aaa to C to designate the relative investment qualities of bonds. The Aa rating is in the second highest of the rating categories. The modifier 2 indicates that the bonds are in the middle range of the Aa category. Moody's describes its Aa ratings as "Bonds which are rated Aa are judged to be a high quality by all standards. They are rated lower than the best bond because margins of protection may not be as large as in Aaa or fluctuation of protection elements may be of greater amplitude or there may be other elements present which make the long term risk appear somewhat larger than Aaa securities."

Standard & Poor's and Fitch issue ratings from AAA to D to designate the relative investment qualities of bonds. The AA rating is the second highest of the ten such ratings. Standard & Poor's and Fitch describe their rating as "Debt rate AA+ has a very strong capacity to pay interest and repay principal and differs from the highest rated issues only in small degree. Plus or minus signs are used to show relative standing within the major rating categories."

Additional information on Shelby County Government's long-term debt can be found in note IV(H) of the Notes to Financial Statements of this report.

### **Economic Factors and Next Year's Budgets and Rates**

- The September 2008 unemployment rate for Shelby County was 7.4 percent and the State of Tennessee's rate was 6.9%, compared to the national rate of 6.0%.
- Economic conditions in the region, beginning with the recent liquidity crisis in the capital markets, parallel those across the nation.
- There has been an increase in home foreclosure rates and a significant weakening of the housing market. As the County approaches completion of a once-every-four-years' comprehensive property reappraisal, there are concerns regarding the impact on property taxes.

For fiscal 2009, the property tax rate was maintained at the same level as fiscal 2008. Compared to actual revenue for 2008, we have budgeted no growth in property taxes for 2009.

For fiscal 2009, general fund revenue is budgeted as a 0.90% reduction from the 2008 budget. General fund expenditures were budgeted to decrease by 2.52% compared to 2008. The budget was balanced by eliminating raises for employees, elimination of positions, and offering a buyout to employees over age 65. A hiring freeze was implemented as well as a freeze on reclassifications. Small increases in budgeted expenditures are primarily due to an increase in health insurance, utility costs, the jail medical contract and other post employment benefits. The County Mayor and Commission are committed to holding general fund expenditures in line with general fund revenue growth. A consulting firm was engaged in 2004 to perform an efficiency study and assist us in preparing a five year strategic plan which was completed in October 2004. Substantial efficiencies have been identified and implemented. The efficiency study and five year strategic plan was updated in FY2008.

Because of the school capital needs and converting notes payable to long term debt to take advantage of low interest rates, debt service expenditures are increasing by approximately \$1 million in 2009. FY2009 is the final year of the Joint Funding Agreement by which \$60,000,000 is allocated to the Memphis City and Shelby County Schools based upon the average daily attendance rate (ADA). Future funding for school capital needs will be determined by the Shelby County Board of Commissioners based upon the recommendation of the Needs Assessment Committee. Based upon current projections, debt service requirements will increase through FY2011 and begin to decline in FY2012. Capital outlays have been reduced from \$154 million in 2002 to \$75 million in 2009. The County plans to maintain Capital Improvement Outlay at or below this level to manage the County's debt plan.

### **Requests for Information**

This financial report is designed to provide a general overview of Shelby County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Administrator, Department of Finance, Shelby County Government, 160 North Main Street, Memphis, Tennessee 38103.