
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, 2015. 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."

Effective for the fiscal year ending June 30, 2015, Shelby County Government implemented GASB Statement Numbers 68 and 71 related to pension accounting. See Note IV(Q) for more information. For purposes of providing comparative information, the FY 2014 financial information used in this discussion and analysis has also been restated.

Financial Highlights

- At June 30, 2015 the unassigned fund balance for the General Fund was \$107.8 million, 28.2% of total General Fund revenue, an increase of \$5.3 million during the year. The unassigned fund balance at the end of the previous year was \$102.5 million, or 26.9% of General Fund revenue.
- Fund balance for the Debt Service Fund increased \$4.1 million to \$91.4 million, which is 48.6% of total revenue of the Debt Service Fund. The balance is consistent with our debt plan to provide for future debt service requirements.
- Grant fund revenues decreased from \$104.5 million to \$73.8 million and expenditures decreased from \$106.6 million to \$76.9 million, primarily due to the shift of the Head Start program from Shelby County Government to another entity. Fund balance decreased slightly from \$16.5 million to \$16.2 million.
- The change in net position for Business-type activities was an increase of \$7.7 million during the year, reducing the net position to a negative \$3.9 million. The negative position results from the implementation of GASB Statement No. 68 requiring the recording of an unfunded pension obligation of \$43.7 million as of June 30, 2015.
- Total government-wide net position increased \$143.6 million as a result of activity for the fiscal year, with an increase of \$135.8 million from governmental activities and an increase of \$7.8 million from business-type activities.
- Total long-term liabilities of governmental activities decreased \$184.1 million to \$1,476.8 million. The decrease is due to the County's continuing effort to pay off more long-term debt than new debt issued each year and to reductions in the unfunded pension obligation.

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 and Other Statements and Schedules
- Other Budgetary Comparison Schedules

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 Position includes capital assets and long-term debt, whereas the fund Balance Sheet includes 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 Position and the Statement of Activities.

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 Position* presents information on all of Shelby County's assets plus deferred outflows of resources and liabilities plus deferred inflows of resources, with the difference between the two reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of changes in the financial position of Shelby County. The County has in prior years issued substantial amounts of debt for capital assets of others, such as the Shelby County Schools. This debt is a liability of the County but the buildings constructed with the funds are not assets of the

County; thus the County has a deficit net position. In some years the County may issue enough similar debt that an annual decrease in net position occurs.

The *Statement of Activities* presents information showing how the government's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying economic 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 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 (Regional One), Agricenter International, and the Emergency Communications District (9-1-1). 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 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 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 fourteen 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 nine 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, Fire Services and Correction Center. *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. The Corrections Center is reported as a major enterprise fund and all internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the nonmajor 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 statements 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 Fiduciary Funds statements report the Agency Fund and the combined Shelby County Retirement System and the Shelby County OPEB Trust, which are reported separately in a *combining statement* elsewhere in this report.

Component units combining statement. 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 Position* and a *Combining Statement of Activities* are included in the fund financial statements section of the basic financial statements.

Budgetary Comparison Statements. Within this section are budgetary comparison statements 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 and Other Statements and Schedules" and "Other Budgetary Comparison Schedules."

Notes to 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.

COMBINING AND OTHER STATEMENTS AND SCHEDULES

Combining fund statements for the non-major enterprise funds, non-major special revenue funds, and internal service funds are included in this section of the report. Supplemental schedules include budgetary comparisons, detail of county charter 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 Position (see the government-wide financial statements for the full version as of June 30, 2015). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2015 and as of June 30, 2014.

Property taxes receivable is by far the largest portion of Shelby County's assets and deferred outflows (43.6% at June 30, 2015 and 43.9% at June 30, 2014). The June 30, 2015 property taxes receivable includes \$763.5 million, offset by an equal unavailable revenue amount in deferred inflows of resources, which became a property lien on January 1, 2015 but are levied for next fiscal year's operations. The similar amount at June 30, 2014 was \$754.7 million. Total assets and deferred outflows of resources increased by \$19.5 million. This includes a decrease in deferred outflows of \$1.1 million and increases in property taxes receivable of \$3.4 million, capital assets of \$1.6 million and current and other assets of \$15.6 million.

Liabilities and deferred inflows decreased by \$127.1 million during the year. Significant changes included a decrease of \$198.7 million in long-term liabilities and an increase of \$63.5 million in deferred inflows of resources.

Table 1
Condensed Statement of Net Position
As of June 30, 2015 and June 30, 2014

| | June 30, 2015 | June 30, 2014 | Change |
|--|-------------------------|-------------------------|-----------------------|
| <u>Governmental Activities</u> | | | |
| Property taxes receivable | \$ 810,261,727 | \$ 806,833,994 | \$ 3,427,733 |
| Current and other assets | 371,226,452 | 358,913,774 | 12,312,678 |
| Capital assets | 542,433,908 | 540,176,170 | 2,257,738 |
| Deferred outflows of resources | 76,707,887 | 83,262,023 | (6,554,136) |
| Total assets and deferred outflows | <u>1,800,629,974</u> | <u>1,789,185,961</u> | <u>11,444,013</u> |
| Long-term liabilities | 1,476,836,312 | 1,660,897,365 | (184,061,053) |
| Other liabilities | 99,307,714 | 92,857,983 | 6,449,731 |
| Deferred inflows of resources | 864,513,715 | 811,280,033 | 53,233,682 |
| Total liabilities and deferred inflows | <u>2,440,657,741</u> | <u>2,565,035,381</u> | <u>(124,377,640)</u> |
| Net investment in capital assets | 328,439,765 | 382,836,247 | (54,396,482) |
| Restricted | 42,020,008 | 42,862,828 | (842,820) |
| Unrestricted | (1,010,487,540) | (1,201,548,495) | 191,060,955 |
| Total net position | <u>(640,027,767)</u> | <u>(775,849,420)</u> | <u>135,821,653</u> |
| <u>Business-Type Activities</u> | | | |
| Current and other assets | 28,168,003 | 24,863,645 | 3,304,358 |
| Capital assets | 23,652,254 | 24,304,435 | (652,181) |
| Deferred outflows of resources | 5,406,725 | 5,347,778 | 58,947 |
| Total assets and deferred outflows | <u>57,226,982</u> | <u>54,515,858</u> | <u>2,711,124</u> |
| Long-term liabilities | 49,171,366 | 63,861,193 | (14,689,827) |
| Other liabilities | 1,663,863 | 2,315,724 | (651,861) |
| Deferred inflows of resources | 10,306,883 | 0 | 10,306,883 |
| Total liabilities and deferred inflows | <u>61,142,112</u> | <u>66,176,917</u> | <u>(5,034,805)</u> |
| Net investment in capital assets | 23,583,102 | 24,169,229 | (586,127) |
| Unrestricted | (27,498,232) | (35,830,288) | 8,332,056 |
| Total net position | <u>(3,915,130)</u> | <u>(11,661,059)</u> | <u>7,745,929</u> |
| <u>Total Primary Government</u> | | | |
| Property taxes receivable | 810,261,727 | 806,833,994 | 3,427,733 |
| Current and other assets | 399,394,455 | 383,777,419 | 15,617,036 |
| Capital assets | 566,086,162 | 564,480,605 | 1,605,557 |
| Deferred outflows of resources | 82,114,612 | 83,262,023 | (1,147,411) |
| Total assets and deferred outflows | <u>1,857,856,956</u> | <u>1,838,354,041</u> | <u>19,502,915</u> |
| Long-term liabilities | 1,526,007,678 | 1,724,758,558 | (198,750,880) |
| Other liabilities | 100,971,577 | 92,857,983 | 8,113,594 |
| Deferred inflows of resources | 874,820,598 | 811,280,033 | 63,540,565 |
| Total liabilities and deferred inflows | <u>2,501,799,853</u> | <u>2,628,896,574</u> | <u>(127,096,721)</u> |
| Net investment in capital assets | 352,022,867 | 407,005,476 | (54,982,609) |
| Restricted | 42,020,008 | 42,862,828 | (842,820) |
| Unrestricted | (1,037,985,772) | (1,237,378,783) | 199,393,011 |
| Total net position | <u>\$ (643,942,897)</u> | <u>\$ (787,510,479)</u> | <u>\$ 143,567,582</u> |

“Net Position” is the difference between assets plus deferred outflows and liabilities plus deferred inflows 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 position is the large negative net position amount. The major factor causing this negative net position 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 (Regional One). 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 municipal school districts within Shelby County. As a result of reporting the debt liabilities without reporting the assets acquired with the proceeds of the debt, a negative net position amount is reported in the County’s Statement of Net Position. If the related capital assets were reported by the County or the debt were reported by the benefiting entities, the County would have a significant, positive net position.

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

| | <u>June 30, 2015</u> | <u>June 30, 2014</u> |
|---|-------------------------|-------------------------|
| Shelby County and Municipal Public School Systems | \$ 941,290,513 | \$ 1,017,631,941 |
| Shelby County Health Care Corp. (Regional One) | 37,264,353 | 44,864,869 |
| Memphis and Shelby County Port Commission | 18,542,500 | 19,082,500 |
| Other | <u>23,856,567</u> | <u>26,454,898</u> |
| Total | <u>\$ 1,020,953,933</u> | <u>\$ 1,108,034,208</u> |

Shelby County, the component units, and other entities 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 position for governmental activities increased by \$135.8 million. The decrease in restricted net position is primarily reflected in the increase in unrestricted assets as long-term debt was paid down without a matching increase in borrowing. The significant reasons for these changes can be generally understood from information in the sections below about “Changes in Net Position” and the “Financial Analysis of the Government’s Funds.” Changes in net position are discussed below.

CHANGES IN NET POSITION – REVENUES, EXPENSES AND TRANSFERS

Table 2 summarizes the financial activity for the County as a whole for the fiscal year ended June 30, 2015, with comparative amounts for the fiscal year ended June 30, 2014.

Table 2
Shelby County Change in Net Position
Fiscal Years Ended June 30, 2015 and 2014

| | FY 2015 | FY 2014 | Change |
|--|-------------------------|-------------------------|-----------------------|
| Governmental activities: | | | |
| <u>Revenues:</u> | | | |
| Program revenues: | | | |
| Charges for services | \$ 117,498,955 | \$ 117,881,890 | \$ (382,935) |
| Operating grants and contributions | 62,656,592 | 97,596,210 | (34,939,618) |
| Capital grants and contributions | 10,340,712 | 5,126,100 | 5,214,612 |
| Total program revenues | <u>190,496,259</u> | <u>220,604,200</u> | <u>(30,107,941)</u> |
| General revenues: | | | |
| Property taxes | 790,149,240 | 784,897,520 | 5,251,720 |
| Other taxes | 93,386,259 | 89,006,378 | 4,379,881 |
| Other | 2,117,748 | 1,929,552 | 188,196 |
| Total general revenues | <u>885,653,247</u> | <u>875,833,450</u> | <u>9,819,797</u> |
| Total revenues-governmental activities | <u>1,076,149,506</u> | <u>1,096,437,650</u> | <u>(20,288,144)</u> |
| <u>Expenses:</u> | | | |
| General government | 43,713,313 | 49,990,734 | (6,277,421) |
| Hospital | 26,816,000 | 26,815,406 | 594 |
| Planning and development | 7,907,742 | 8,218,651 | (310,909) |
| Public works | 43,737,574 | 42,763,697 | 973,877 |
| Corrections | 1,058,422 | 1,041,443 | 16,979 |
| Health services | 50,765,349 | 53,411,088 | (2,645,739) |
| Community services | 40,742,530 | 69,437,121 | (28,694,591) |
| Law enforcement | 156,314,046 | 162,063,175 | (5,749,129) |
| Judicial | 69,221,549 | 72,191,634 | (2,970,085) |
| Other elected officials | 28,753,179 | 25,886,210 | 2,866,969 |
| Education | 385,396,412 | 387,263,290 | (1,866,878) |
| Debt interest | 76,735,064 | 66,185,593 | 10,549,471 |
| Total expenses-governmental activities | <u>931,161,180</u> | <u>965,268,042</u> | <u>(34,106,862)</u> |
| Increase (decrease) in net position before transfers | 144,988,326 | 131,169,608 | 13,818,718 |
| Transfers | <u>(9,166,673)</u> | <u>(7,273,785)</u> | <u>(1,892,888)</u> |
| Increase (decrease) in net position | 135,821,653 | 123,895,823 | 11,925,830 |
| Net position - beginning of year | <u>(775,849,420)</u> | <u>(899,745,243)</u> | <u>123,895,823</u> |
| Net position - end of year | <u>\$ (640,027,767)</u> | <u>\$ (775,849,420)</u> | <u>\$ 135,821,653</u> |

For governmental activities, program revenues are those 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 activities of the County; property taxes are the primary source of general revenue. Program revenues decreased by 13.6% or \$30.1 million, primarily due to lower funding levels from grants and especially the move of the local Head Start program to another entity. The County considers grant and reimbursement revenues from other governments associated with the current fiscal year to be available if collected within one year of the end of the current fiscal year. Total general revenues increased \$9.8 million. Property taxes increased \$5.3 million (0.7%) and other taxes increased \$4.4 million (4.9%), with relatively small increases and decreases in the various taxes.

Total expenses for the year in governmental activities decreased \$34.1 million (3.5%). Community Services grants decreased \$28.7 million, primarily due to the movement of the Head Start program to another entity. Significant decreases occurred in general government (\$6.3 million or 12.6%) and law enforcement (\$5.7 million or 3.5%), with increases and decreases in other programs. Debt expenses increased \$10.5 million.

Table 2 Continued

| Business-type activities: | FY 2015 | FY 2014 | Change |
|--|------------------|------------------|----------------|
| <u>Revenues:</u> | | | |
| Operating revenues: | | | |
| Charges for services | \$ 81,119,037 | \$ 80,713,882 | \$ 405,155 |
| Operating grants and contributions | 1,414,323 | 871,967 | 542,356 |
| Capital grants and contributions | 0 | 0 | 0 |
| Total operating revenues | 82,533,360 | 81,585,849 | 947,511 |
| Non-operating revenues | 39,976 | 48,675 | (8,699) |
| Total revenues | 82,573,336 | 81,634,524 | 938,812 |
| <u>Expenses:</u> | | | |
| Operating expenses | 83,994,080 | 86,696,132 | (2,702,052) |
| Total expenses | 83,994,080 | 86,696,132 | (2,702,052) |
| Increase (decrease) in net position before transfers | (1,420,744) | (5,061,608) | 3,640,864 |
| Transfers | 9,166,673 | 7,273,785 | 1,892,888 |
| Increase (decrease) in net position | 7,745,929 | 2,212,177 | 5,533,752 |
| Net position - beginning of year | (11,661,059) | (13,873,236) | 2,212,177 |
| Net position - end of year | (3,915,130) | (11,661,059) | 7,745,929 |
| Total primary government: | | | |
| Increase (decrease) in net position | 143,567,582 | 126,108,000 | 17,459,582 |
| Net position - beginning of year | (787,510,479) | (913,618,479) | 126,108,000 |
| Net position - end of year | \$ (643,942,897) | \$ (787,510,479) | \$ 143,567,582 |

In business-type activities, operating revenues increased slightly by \$947,511 or 1.2%. This was due to an increase of \$1,007,699 in Code Enforcement’s charges for services and operating grants. There was a small increase of \$48,609 in Fire Services and a small decrease of \$108,797 in the Corrections Center. The operating grant of \$1,366,844 in Codes Enforcement is an operating subsidy from the City of Memphis. Operating expenses decreased \$2,702,052 overall, or 3.2%; decreases were \$156,889 in Fire Services, \$729,654 in Codes Enforcement and \$1,815,509 in the Corrections Center. Transfers increased \$1.9 million, almost all in the Corrections Center.

CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during the current fiscal year was an increase in net position of \$143.6 million. The County’s governmental activities operated with an increase in net position of \$135.8 million. The business-type activities had a net increase of \$7.8 million. This resulted in the County’s overall net position improving from a deficit balance of \$787.5 million to a deficit balance of \$643.9 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, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Governmental accounting standards prescribe fund balance categories in a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed on the use of the resources reported in governmental funds. The categories, in order of the constraints, are nonspendable, restricted, committed, assigned and unassigned. More details on these classifications are presented in the Notes to Financial Statements I(E) under “Net Position and Fund Balance.”

As of the end of the current fiscal year, Shelby County’s governmental funds reported a combined ending fund balance of \$278,611,345. The components of the balances are:

| | <u>June 30, 2015</u> | <u>June 30, 2014</u> |
|-------------------------------------|-----------------------|-----------------------|
| General Fund | \$ 108,743,411 | \$ 103,387,753 |
| Debt Service Fund | 91,413,446 | 87,271,602 |
| Special Revenue Funds | <u>39,743,999</u> | <u>38,301,618</u> |
| Total, except Capital Projects Fund | 239,900,856 | 228,960,973 |
| Capital Projects Fund | <u>38,710,489</u> | <u>34,183,061</u> |
| Total all governmental funds | <u>\$ 278,611,345</u> | <u>\$ 263,144,034</u> |

There was a \$10.9 million net increase in fund balance, excluding capital projects. There were increases of \$5.4 million in the General Fund, \$4.1 million in the Debt Service Fund and \$1.4 million in all special revenue funds. There was also an increase of \$4.5 million in the Capital Projects Fund. Each of these changes is discussed below.

The *General Fund* is the chief operating fund of Shelby County and operated with a net increase in fund balance of \$5.4 million, compared to an increase of \$7.6 million in the previous year. The General Fund Revenue in total increased \$1.4 million over the prior year. Property taxes increased \$5.6 million (2.3%). Other local taxes were \$1.7 million lower (5.0%) and federal and local revenue were \$4.0 million lower (35.6%). Other revenues had smaller dollar increases and decreases. Total revenues in FY 2015 exceed expenditures by \$22.2 million compared to revenues over expenditures of \$25.1 million in FY 2014. General Fund expenditures and net other financing sources/uses increased \$3.7 million. One significant increase was \$4.1 million in Other Elected Officials, mostly related to the reclassification of the Election Commission into this category. Another significant increase was \$1.5 million in Judicial, mostly related to increased costs in Juvenile Court and the Public Defender related to juvenile cases. A significant decrease was \$2.3 million in general government due to the shift of the Election Commission. Net transfers out decreased by \$1.3 million. The General Fund unassigned fund balance increased \$5.3 million to \$107.8 million; this amount is available for spending at the government's discretion.

As a measure of the General Fund's liquidity, it may be useful to compare the unassigned fund balance to total fund revenue. Unassigned fund balance represents 28.2% of total General Fund revenue. Management is committed to maintaining an unassigned fund balance in the General Fund between 25% and 30% of General Fund revenue.

The *Debt Service Fund* total fund balance increased \$4.1 million during the year to \$91.4 million, all restricted or committed for the payment of debt service. Tax revenue increased \$11.5 million during the year and other revenue did not change significantly, but a transfer out of \$6.5 was made. Debt Service expenditures decreased by \$5.9 million.

The fund balance of the *Capital Projects Fund* fluctuates significantly as funds are borrowed or transferred in for capital project purposes and are then expended for the projects. This fund balance increased \$4.5 million during the year, from \$34.2 million to \$38.7 million. Expenditures for various capital projects were \$26.7 million and net transfers in of \$8.6 million were received. Short term debt of \$20 million was issued during the year; see Note IV(H) to the financial statements. All fund balances of the Capital Projects Fund are restricted, committed or assigned.

The *Education Fund* is used to provide local funding to the Shelby County Board of Education and six municipal school districts that opened this fiscal year. A portion of the County property tax is specifically assessed for the schools. To the extent the property tax revenues are less than the expenditure amount appropriated, wheel tax revenues are allocated to the education fund to provide the total funding appropriated. There is usually no net change in fund balance and no fund balance in the Education Fund; the fund balance at June 30, 2015 was zero.

The *Grants Fund* fund balance decreased slightly from \$16.5 at June 30, 2014 to \$16.2 million at the end of the current year. Total revenue decreased \$30.7 million to \$73.8 million. The major decrease was the result of the local Head Start program being moved to another entity. Total expenditures decreased \$29.7 million during the year, also primarily due to the Head Start program moving to another entity.

All the *Nonmajor Governmental Funds* are special revenue funds. All these 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. These funds in total had a net increase of \$1.7 million in fund balances during the year. Significant changes in individual fund balances were a \$0.9 million increase in the Roads and Bridges Fund and a \$1.1 million increase in the Hotel Motel Tax 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. In total these funds had an increase of \$7.7 million in net position during the year. Total net position balances at year-end are a \$2.0 million deficit, of which a negative \$25.6 million is unrestricted and \$23.6 is net investment in capital assets. The net deficit balances are the result of recent financial reporting standards that requires proprietary funds to record unfunded net pension liabilities; this liability amount at June 30, 2015 is \$43.7 million.

Corrections Center Fund. The Corrections Center receives reimbursement from the State of Tennessee for housing State prisoners, which accounts for approximately 85% of the prison population. The General Fund provides the remaining cost, excluding depreciation. Operating revenues decreased \$108,797 to \$53.5 million and operating expenses decreased \$1.5 million from \$59.0 million to \$57.5 million. Net transfers to cover the cost of non-State prisoners were \$8.1 million. The overall net position increased \$4.1 million from \$1.6 million to \$5.7 million.

Consolidated Codes Enforcement Fund. Operating revenue increased \$0.4 million to \$8.4 million and operating expenses decreased \$0.5 million to \$8.7 million. The County's general fund and the City of Memphis contributed \$1.4 million each to support operations, an increase of \$0.6 million each from the previous year. The change in net position increased from a negative \$5.5 million to a negative \$3.3 million at June 30, 2015. The net negative position at June 30, 2015 of \$3.3 million consists of a positive \$1.7 million investment in capital assets and a negative unrestricted balance of \$5.0 million.

Fire Services Fund. This fund operates primarily on user fees collected from residents and businesses in the unincorporated areas of the County served by the department. In the current year revenue from fees was \$18.2 million and other operating revenue was \$1.0 million, an increase of \$35,609. A small transfer of \$9,501 was also recorded. Operating expenses decreased from \$17.9

million to \$17.8 million. The change in net position for the year was \$1.5 million. Total net position improved from a negative \$5.9 at June 30, 2014 to a negative \$4.4 million at June 30, 2015.

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.* Internal service funds provide goods or services to other funds or departments on a cost-reimbursement basis. At June 30, 2015, these funds combined had net position of \$24.2 million, a decrease of \$0.4 million. The Group Health Insurance Fund had a decrease of \$1.8 million to a total net position of \$5.2 million. The Employer Insurance Fund had a decrease of \$0.2 million to a net position of \$6.8 million. The Tort Liability Fund had an increase of \$0.9 million to a net position of \$5.8 million. The Central Services Fund had a net increase of \$0.7 million to a net position of \$6.4 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 actuarial value of accumulated funds in the Retirement System at June 30, 2015 was 79.0% of the currently calculated actuarial accrued liability. The County provides funding as required each year for the increased liability for benefits being earned by current employees. At June 30, 2015 the Retirement System had net position held in trust of \$1,115 million, a decrease of \$22.5 million, primarily due to decreased market value of investments.

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. At June 30, 2015 the Trust had net position held in trust of \$197.9 million, an increase of \$20.3 million for the year. Investment income for the year was \$1.4 million compared to \$21.2 million in the prior year. The ratio of current funding to the actuarial liability was 56.8% at the latest actuarial valuation (June 30, 2014).

The County also maintains agency funds for a number of the County's county charter officers. 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 overall increase in the revenue budget from original to amended was insignificant in total - less than \$100,000 (.02%).
- The original budget for expenditures was increased by about \$1 million (0.3%) in total, primarily due to amounts carried forward from prior year for open encumbrances. An increase in the amended budget for "Transfers Out" includes a transfer of \$1.8 million to the Education Fund for a school facilities study approved by the County Commission.

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- Budget amendments to Planned Change in Fund Balance reflect two non-recurring education items approved by the County Commission: \$3.0 million for Pre-Kindergarten programs and \$1.8 million for a facilities study of the schools.
 - Actual revenues exceeded the amended budget by \$9.4 million, which is 2.5% more than the budgeted level. Property tax collections contributed \$7.3 million to that amount. Additional revenue collected in the "Other Local Taxes" category primarily reflects continued strong Business Tax collections.
 - Actual total expenditures were \$.8 million (0.2%) less than the amended budget. Favorable division variances resulted from personnel savings related to vacancies and attrition. These savings were largely offset by the salary restriction budgeted in the Central Operations section of Administration & Finance. Use of fund balance was not necessary to make the payments authorized by the Commission for pre-kindergarten programs and the school facilities study.

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, 2015 amounts to \$566.1 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 \$34.2 million and depreciation was \$27.2 million. Construction in progress as of the end of the current fiscal year was \$35.1 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:

- Expenditures of \$3.1 million were made for the replacement system for the Criminal Justice computer systems.
- Expenditures of \$1.3 million were made for the Sheriff's Office Range Operations Building project.
- Appropriations of \$13.9 million were approved in the previous year for a new ERP system for the Shelby County Schools. Expenditures for obtaining and implementing this system were approximately \$2.0 million in the fiscal year.
- Renovation work continued on the Shelby County Office Building at 160 North Main. Expenditures on these renovations for the fiscal year were approximately \$8.8 million.

Long-term debt. At June 30, 2015 Shelby County's general obligation bonded debt (bonds payable) totaled \$1,153 million, which represented approximately 6.4% of assessed value of taxable property. The County's bonds, loans and notes payable decreased by approximately \$132 million (10.3%) 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.

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 may be 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. In December 2014 the Shelby County Board of Commissioners authorized the issuance of Capital Outlay Extendible Municipal Commercial Paper (EMCP) Notes, 2015 Series A Program. The aggregate outstanding principal amount may not exceed \$120 million at any time. The amount of \$20 million was outstanding at June 30, 2015 and was reported as short-term debt.

During FY 2013, as part of a capital lease agreement, the State of Tennessee issued Tax Exempt revenue bonds for the construction of a Regional Forensic Center. The County has agreed to provide the State the funds, as they become due, to make principal and interest payments over the next twenty (20) years on \$8 million of the bonds, which had a balance of \$6,131,862 at June 30, 2015. In September 2011 the County and the City of Memphis agreed to provide the funds necessary to pay the principal and interest on \$20 million each of bonds issued by the Memphis and Shelby County Port Commission for a specific economic development project. At June 30, 2015 the County’s principal obligation was \$18.5 million. The Port Commission debt is reported with bonds and other long-term debt as detailed in Note IV(H) of the financial report.

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. |
| Aa1 | 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 1 indicates that the bonds are in the top 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

Economic Factors. According to the Tennessee Department of Labor, the unemployment rate for Shelby County as of September 30, 2015 was 6.7%, as compared to the state's rate of 5.7% and the national rate of 5.1%. (All rates are seasonally adjusted.)

Next Year's Budgets and Rates.

- The property tax rate for the FY 2016 budget has been maintained at \$4.37 for FY 2016, with the same allocations to Education, Debt and the General Fund. The budget includes estimated growth of 1% in property taxes over prior year actual collections.
- Total general fund revenue is budgeted at \$8.1 million (2%) more than the prior year level. In addition to property tax growth, the budget reflects a favorable elections cycle of 100% federal and local reimbursable elections.
- Total general fund expenditures for FY 2016 are budgeted at \$6.6 million more than the prior year, including a 1.7% cost of living salary increase and longevity pay for employees. The County Commission also approved increases of \$3 million to support criminal justice programs – largely related to Juvenile Court detention and security functions, \$1 million for health and blight control programs, and \$1.3 million for grants to community non-profit agencies.
- An additional \$10 million was allocated to Education for FY 2016 as a result of funds available from property tax collections and declining debt service obligations. The Shelby County Schools face significant budgetary challenges ahead as the issues of OPEB liability and declining enrollment are addressed.
- No planned use of fund balance has been included in the FY 2016 budget.

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, Suite 800, Memphis, Tennessee 38103.