



Shelby County Government

MARK H. LUTTRELL, JR.
MAYOR

November 23, 2011

To the Members of the Board of County Commissioners and the Citizens of Shelby County, Tennessee:

The comprehensive annual financial report of Shelby County, Tennessee (hereafter, Shelby County) for the year ended June 30, 2011 is hereby submitted as required by both local ordinances and state statutes. These require that Shelby County publish each fiscal year a complete set of financial statements as required by Generally Accepted Accounting Principles (GAAP) and audited by a firm of licensed certified public accountants.

Management assumes full responsibility for the completeness and reliability of all of the information presented in this report based upon a comprehensive framework of internal controls that have been established for this purpose. Because the cost of internal controls should not exceed anticipated benefits, the objective is to provide reasonable rather than absolute assurance that the financial statements are free from any material misstatement.

Watkins Uiberall PLLC and Banks Finley White and Company, certified public accountants, have issued an unqualified opinion on Shelby County's financial statements for the fiscal year ended June 30, 2011. The independent auditors' report is presented as the first component of the financial section of this report.

Management's Discussion and Analysis (MD&A) immediately follows the independent auditor's report and provides an analysis of the basic financial statements. MD&A complements this letter of transmittal and should be read in conjunction with it.

Profile of Shelby County, Tennessee

Shelby County, established in 1819, is the largest county in the State of Tennessee with Memphis as the County seat. The County is located in the extreme southwest corner of Tennessee on the east bank of the Mississippi River and is the hub of the 105 county Mid-South Region. Contained within the County's 783 square miles are seven incorporated municipalities, including Arlington, Bartlett, Collierville, Germantown, Lakeland, Memphis and Millington. The population of the County is 927,644. The County is empowered to levy, without limit, a property tax on both real and personal property located within its boundaries.

The County operates under the Mayor-Commission form of government. The Mayor, as the County's chief executive officer, oversees the operations of the County's six divisions. The

thirteen members of the Shelby County Board of Commissioners (the Commission), the legislative branch of the government, review and approve the County's programs and budgets. The Mayor and each Commissioner serve a four year term. The Sheriff, County Clerk, Assessor, Register, Trustee, Circuit Court Clerk, Criminal Court Clerk, General Sessions Court Clerk, Juvenile Court Clerk and Probate Court Clerk are also elected to four year terms.

Shelby County provides a full range of services, including law enforcement, judicial system, jail and corrections facilities, health services, community services, fire protection and recreational activities. Shelby County also is financially accountable for a legally separate school district, public hospital, agricultural center and emergency communications district, which are reported separately within the Shelby County financial statements. Additional information on these entities can be found in Note I. A. in the notes to the financial statements.

The annual budget serves as the foundation for Shelby County's financial planning and control. All departments and elected officials submit their requested budget to the County Mayor by late February. After a series of reviews, the County Mayor presents a proposed consolidated budget to the County Commission. The County Commission holds budget hearings and then adopts a final budget. This process is generally completed by July 1, the start of the fiscal year. However, the County Commission has the authority to adopt a continuing budget until a final budget can be adopted. The appropriated budget is prepared by fund, division (function such as public works), and department (e.g., parks). The Mayor may make transfers of appropriations within personnel or non-personnel categories within a department or between departments within a division. Any other transfers require approval of the County Commission.

Local economy

Shelby County experienced a decline in the local economy this past year as did most of the country. The decline in the housing market has not been as severe as in much of the country because our housing market had been relatively steady rather than experiencing excessive growth. In recent years, the economy of the County has experienced notable success attracting new businesses along with the continued growth of existing businesses.

The County is the major wholesale and retail center for western Tennessee, eastern Arkansas and northern Mississippi. The Memphis MSA is considered one of the top 100 suburban markets and ranks in the top fifty in total effective buying income according to Sales & Marketing magazine. The industrial economy of the County encompasses not one, but many industries. Twenty major industrial groups, as classified by the Bureau of the Budget, are listed in the Directory of Memphis Manufacturers. Major industries include chemicals, electronics, foods and beverages, paper products, hardwood lumber products, pharmaceuticals, soybean and cotton oil derivatives and fertilizers.

The major areas of employment in Shelby County are the services, government, and wholesale and retail trade. Comparatively, both the Southeast Region and the United States overall show a heavier concentration in manufacturing than does the County, but they also display lower employment in transportation and public utilities. According to the Tennessee Department of Labor, the unemployment rate for Shelby County as of September 30, 2011 was 10.8%, as compared to the state's rate of 9.8% and the national rate of 9.1%.

Long-term financial planning

Long-term planning includes both our operations and capital needs. We look at our historical data and project our future requirements. Close cooperation exists between the Administration and the Commission, including an open, thorough and timely budgeting process, which focuses on a clear understanding of debt funding, in addition to funding for operations.

During the past ten years, governmental total revenue has increased 33%. For this period, local taxes have increased as a percent of total revenue from 75.4% to 76.6% because the areas of relative increase in expenditures are primarily supported by local taxes. For this period, property taxes have increased from 65.6% to 67.9% of total revenue. While Shelby County did incur a small decline in property taxes in 2011 compared to 2010, this decline was less than 1% because our property tax base is much more stable than many parts of our country. An increase in grants caused State, Federal and Other Local revenue to increase from 14.1% to 15.4% as a percent of total revenue over the past ten years. Fines, fees and permits have decreased from 6.9% of total revenue to 6.6% and all other revenues have decreased from 3.6% to 1.4%. Most fees and fines as well as many other revenues are set by the State and are not regularly increased to provide for inflationary cost increases. Other revenue declined primarily in investment income due to the extremely low interest rates in 2011.

During this same ten year period, excluding capital projects, the County's governmental expenditures related to our core functions of education, law enforcement, judicial and health plus debt service have decreased as a percent of total expenditures from 82.6% to 80.3%. An increase in grants such as Head Start has caused Community Service expenditures to increase from 4.9% to 7.9% of total expenditures. In total governmental expenditures have increased 34%, which is consistent with the increase in revenue.

As part of our annual budget process, operating revenue and expenditures are projected for the next five years. This provides a basis to consider the longer term implications of decisions regarding items such as new programs, program level changes, raises, benefits and the property tax rate. We have also considered the need to plan for cash flow requirements. Our property taxes become delinquent on March 1 and most payments are received in December (for individual income tax purposes) and February. With our fiscal year starting July 1, we will always have negative cash flow from July 1 through late December. For many years we utilized short term borrowing for these cash flow needs. In 2009 the County adopted a policy of maintaining the General Fund unassigned fund balance as a percent of General Fund revenue between 15% and 25%. This percentage has increased for eight consecutive years and is 23.3% as of June 30, 2011. A result of increasing fund balances, in 2009 the County ended the use of short term borrowing for cash flow purposes.

Annually, as part of the budget process the County adopts a five year capital improvements plan. Several years ago we recognized the need to stop the growth in both our debt outstanding and our annual debt service payments. We have aggressively reduced the local funding of our capital plan from over \$150 million in 2003 to approximately \$75 million annually in 2008 and thereafter to stop the growth of debt. In December 2006, our general obligation debt, excluding accretion, peaked at \$1.85 billion and it has declined to \$1.62 billion as of June 30, 2011. We expect a slow steady decline in future years as long as we keep our annual local capital funding at approximately \$75 million. Debt service expenditures have also now peaked and will start declining in fiscal 2012.

Major initiatives

The Administration has identified a number of priorities designed to strengthen the long-term financial position of the County as addressed above in long-term financial planning. We have established the following initiatives that focus on structural changes in areas that are important to our future prosperity.

- 1. Economic Development and Smart Growth** – Shelby County is committed to providing programs and policies that ensure aggressive growth and to promote high quality long-term job opportunities. During fiscal 2011 Electrolux and Mitsubishi committed to build large facilities in Shelby County that will directly provide over 1,300 jobs. Smarter development regulations have been adopted that will curtail suburban sprawl and facilitate development. In addition, a joint entity with the City of Memphis has been created called the Economic Development Growth Engine (EDGE) to provide one entity to focus on economic development and to provide companies one entity that can deal with all governmental issues.
- 2. Support Quality Public Education** – In 2011 the Memphis City Schools decided to revoke their charter and consolidate into the Shelby County Schools. The County is providing support to and the Mayor is a member of the Shelby County Schools Transition Planning Commission that is tasked with developing a consolidation plan to be recommended to the Shelby County Board of Education and the State of Tennessee Department of Education. The consolidation of the two schools systems will be effective at the start of the school year in August 2013.
- 3. Focus on Budget and Financial Stability** – Preparation of the first budget of this Administration was focused on shrinking County Government as much as practical while maintaining those services that are important to our citizens. All programs and services were thoroughly evaluated to consider the need for those functions that are not mandated and to provide programs and services more efficiently. We are working with each elected official to enhance efficiency through elimination of duplications particularly of information technologies. Considering the current economic conditions, the fiscal 2012 budget was prepared based on assumptions we believe to be conservative including a 2% decline in property taxes and it is balanced.
- 4. Provide and Promote Community and Environmental Health** – We are committed to provide and support integrated healthcare services that focus on wellness, early intervention and prevention in order to ensure a high quality of life and a safe environment for our citizens. We have had an outside review of our Health Services Division to focus our efforts on integrated healthcare services that focus our efforts in these areas. An “Office of Sustainability” has been established to develop green initiatives and aspects of community and environmental health.
- 5. Provide Efficient and Responsive Government Operations** – A training office has been established to enhance the capabilities and foster professionalism of the employee workforce through improved training programs and succession planning. Trust and confidence in government are being built through transparent, accessible and responsive interactions with all internal and external customers.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Shelby County, Tennessee for its comprehensive annual financial report (CAFR) for the year ended June 30, 2010. This was the twenty-sixth consecutive year that Shelby County has received this prestigious award. In order to be awarded the Certificate of Achievement, a government had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements. The County also received GFOA's Distinguished Budget Presentation Award for the fiscal year ended June 30, 2010.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report could not have been accomplished without the efficient and dedicated services of the entire staff of the Finance Department. We would like to express our appreciation to all members of the departments who assisted and contributed to the preparation of this report. Due credit also is given to all County Commissioners for their interest and support in planning and conducting the operations of Shelby County in a responsible and progressive manner.

Sincerely,



Mark H. Luttrell, Jr.
County Mayor



Harvey Kennedy
Chief administrative Officer



Michael A. Swift
Director, Division of Administration and Finance