

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, 2011. 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, unassigned fund balance for the General Fund was \$85.6 million, or 23.3% of total General Fund revenue. This compares to the unassigned fund balance at the end of the previous year of \$75.7 million, or 21.1% of General Fund revenue.
- Fund balance for the Debt Service Fund increased \$5.3 million to \$107.8 million, which is 57.5% of total revenue of the Debt Service Fund. The balance is consistent with our debt plan to provide for future debt service requirements.
- The Capital Projects Fund balance increased \$38.9 million to a balance of \$140.2 million. This was the primarily the result of the proceeds of a \$67.26 million loan for school capital projects through the State of Tennessee under the Qualified School Construction Bond Program.
- Total liabilities of Shelby County exceed total assets as of June 30, 2011 by \$714.6 million. 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. Outstanding debt for these entities as of June 30, 2011 was \$1,347,100,087.
- Total government-wide net assets increased \$87.8 million as a result of activity for the fiscal year, with an increase of \$87.6 million from governmental activities and an increase of \$0.2 million from business-type activities.

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 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 (The Med), 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 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 twelve 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 seven 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 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 Shelby County Retirement System is the major fiduciary fund, but also included are 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 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, 2011). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2011 and as of June 30, 2010.

Property taxes receivable is by far the largest portion of Shelby County's assets (40.9 % at June 30, 2011 and 44.0% at June 30, 2010). The June 30, 2011 property taxes receivable includes \$741.4 million, offset by an equal unearned revenue amount in other liabilities, which became a property lien on January 1, 2011 but are levied for next fiscal year's operations. The similar amount at June 30, 2010 was \$753.4 million. Total assets increased by \$96.1 million. This included increases in cash and cash equivalents and investments combined of \$34.9 million and deferred derivative outflows of \$74.6 million and a decrease in taxes receivable of \$18.2 million.

Liabilities increased by \$8.3 million during the year. Significant changes included an increase of \$74.6 million for the derivative instruments fair value (offset to the asset increase noted above) and decreases of \$15.3 million in various payables, \$11.2 in unearned revenue and \$39.1 in long-term liabilities.

Table 1
Condensed Statement of Net Assets
As of June 30, 2011 and June 30, 2010

	June 30, 2011	June 30, 2010 (Restated)	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 798,066,867	\$ 816,217,944	\$(18,151,077)
Current and other assets	560,130,762	449,189,750	110,941,012
Capital assets	545,965,961	543,765,068	2,200,893
Total assets	1,904,163,590	1,809,172,762	94,990,828
Long-term liabilities	1,736,783,513	1,777,143,478	(40,359,965)
Other liabilities	918,496,577	870,729,611	47,766,966
Total liabilities	2,655,280,090	2,647,873,089	7,407,001
Invested in capital, net of related debt	328,687,913	240,569,297	88,118,616
Restricted	148,784,078	207,993,719	(59,209,641)
Unrestricted	(1,228,588,491)	(1,287,263,343)	58,674,852
Total net assets	(751,116,500)	(838,700,327)	87,583,827
<u>Business-Type Activities</u>			
Current and other assets	24,116,897	22,604,693	1,512,204
Capital assets	24,792,359	25,154,882	(362,523)
Total assets	48,909,256	47,759,575	1,149,681
Long-term liabilities	9,876,233	8,651,466	1,224,767
Other liabilities	2,482,231	2,768,956	(286,725)
Total liabilities	12,358,464	11,420,422	938,042
Invested in capital, net of related debt	24,274,150	24,388,818	(114,668)
Unrestricted	12,276,642	11,950,335	326,307
Total net assets	36,550,792	36,339,153	211,639
<u>Total Primary Government</u>			
Property taxes receivable	798,066,867	816,217,944	(18,151,077)
Current and other assets	584,247,659	471,794,443	112,453,216
Capital assets	570,758,320	568,919,950	1,838,370
Total assets	1,953,072,846	1,856,932,337	96,140,509
Long-term liabilities	1,746,659,746	1,785,794,944	(39,135,198)
Other liabilities	920,978,808	873,498,567	47,480,241
Total liabilities	2,667,638,554	2,659,293,511	8,345,043
Invested in capital, net of related debt	352,962,063	264,958,115	88,003,948
Restricted	148,784,078	207,993,719	(59,209,641)
Unrestricted	(1,216,311,849)	(1,275,313,008)	59,001,159
Total net assets	\$ (714,565,708)	\$ (802,361,174)	\$ 87,795,466

“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, 2011	June 30, 2010
Shelby County and City of Memphis Schools	\$ 1,192,498,927	\$ 1,185,181,389
Shelby County Health Care Corp. (component unit)	67,348,508	74,932,946
Convention Center (joint venture)	53,964,791	58,273,905
Other	33,287,861	37,542,089
Total	\$ 1,347,100,087	\$ 1,355,930,329

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 increased by \$87.8 million. The net increase in invested in capital assets, net of related debt constituted \$88.0 million of this increase; this was primarily due to the liquidation of long-term debt in an amount greater than the amount of new debt for capital projects. Restricted net assets decreased by \$59.2 million and unrestricted net assets increased by almost an offsetting amount of \$59.0 million. The significant reasons for these changes 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, 2011, with comparative amounts for the fiscal year ending June 30, 2010.

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% or \$24.4 million, primarily due to a net increase in revenues from other governments. Capital grants increased \$15.2 million, including \$9.4 million for developer subdivision road contributions and \$5.4 million of grants for road and infrastructure improvements. General revenues decreased \$16.1 million, with a 2.3% or \$18.0 million decrease in property taxes; this decrease was

consistent with decreases in assessed values of property for tax purposes. Other taxes had a net increase of \$1.3 million, primarily by increases in sales and business taxes.

Table 2
Shelby County Change in Net Assets
Fiscal Years Ended June 30, 2011 and 2010

	FY 2011	FY 2010	Change
Governmental activities:			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 115,155,763	\$ 108,459,891	\$ 6,695,872
Operating grants and contributions	116,897,799	114,344,216	2,553,583
Capital grants and contributions	15,901,708	710,000	15,191,708
Total program revenues	<u>247,955,270</u>	<u>223,514,107</u>	<u>24,441,163</u>
General revenues:			
Property taxes	755,877,920	773,832,412	(17,954,492)
Other taxes	94,978,411	93,635,983	1,342,428
Other	3,620,803	3,105,416	515,387
Total general revenues	<u>854,477,134</u>	<u>870,573,811</u>	<u>(16,096,677)</u>
Total revenues-governmental activities	<u>1,102,432,404</u>	<u>1,094,087,918</u>	<u>8,344,486</u>
<u>Expenses:</u>			
General government	68,219,812	63,105,682	5,114,130
Hospital	36,816,000	38,816,666	(2,000,666)
Planning and development	6,061,205	5,151,177	910,028
Public works	48,985,516	47,801,753	1,183,763
Corrections	1,608,821	1,481,007	127,814
Health services	53,249,533	59,823,299	(6,573,766)
Community services	83,537,889	72,340,940	11,196,949
Law enforcement	152,448,879	149,248,036	3,200,843
Judicial	67,809,546	66,108,459	1,701,087
Other elected officials	26,302,063	25,700,703	601,360
Education	387,692,028	363,281,302	24,410,726
Interest on debt	71,559,500	70,146,945	1,412,555
Total expenses-governmental activities	<u>1,004,290,792</u>	<u>963,005,969</u>	<u>41,284,823</u>
Increase (decrease) in net assets before transfers	98,141,612	131,081,949	(32,940,337)
<u>Transfers</u>	<u>(10,557,785)</u>	<u>(7,683,295)</u>	<u>(2,874,490)</u>
Increase (decrease) in net assets	87,583,827	123,398,654	(35,814,827)
Net assets - beginning of year	<u>(838,700,327)</u>	<u>(962,098,981)</u>	<u>123,398,654</u>
Net assets - end of year	<u><u>\$ (751,116,500)</u></u>	<u><u>\$ (838,700,327)</u></u>	<u><u>\$ 87,583,827</u></u>

Total expenses for the year in governmental activities increased \$41.3 million (4.4%). The increase of \$24.4 million for education was due to capital projects funding during the year, which are expenses to the County since the capital assets resulting from the funding are not County assets. The increase of \$11.2 million in community services resulted from increased grants. The decrease in health services was primarily the result of program reductions because

the City of Memphis discontinued partial funding of the program. The increase in interest was because of lower interest in the previous year due to the liquidation of a swap agreement.

	FY 2011	FY 2010 (Restated)	Change
Business-type activities:			
<u>Revenues:</u>			
Operating revenues:			
Charges for services	\$ 74,759,319	\$ 73,292,415	\$ 1,466,904
Operating grants and contributions	1,736,920	75,600	1,661,320
Total operating revenues	<u>76,496,239</u>	<u>73,368,015</u>	<u>3,128,224</u>
Non-operating revenues	<u>22,979</u>	<u>48,728</u>	<u>(25,749)</u>
Total revenues	<u>76,519,218</u>	<u>73,416,743</u>	<u>3,102,475</u>
<u>Expenses:</u>			
Operating expenses	86,659,348	83,374,056	3,285,292
Non-operating expenses and losses	206,016	-0-	206,016
Total expenses	<u>86,865,364</u>	<u>83,374,056</u>	<u>3,491,308</u>
Increase (decrease) in net assets before transfers	(10,346,146)	(9,957,313)	(388,833)
<u>Transfers</u>	<u>10,557,785</u>	<u>7,683,295</u>	<u>2,874,490</u>
Increase (decrease) in net assets	211,639	(2,274,018)	2,485,657
Net assets - beginning of year	<u>36,339,153</u>	<u>38,613,171</u>	<u>(2,274,018)</u>
Net assets - end of year	<u>36,550,792</u>	<u>36,339,153</u>	<u>211,639</u>
Total primary government:			
Increase (decrease) in net assets	87,795,466	121,124,636	(33,329,170)
Net assets - beginning of year	<u>(802,361,174)</u>	<u>(923,485,810)</u>	<u>121,124,636</u>
Net assets - end of year	<u>\$(714,565,708)</u>	<u>\$(802,361,174)</u>	<u>\$ 87,795,466</u>

In business-type activities, operating revenues increased by \$3.1 million. Of this increase, \$2.9 million was in Corrections Center reimbursement for housing State inmates. Nominal changes occurred in Fire Services and Consolidated Codes Enforcement. However, Consolidated Codes Enforcement revenue included a \$1.7 million operating subsidy from the City of Memphis to fund one-half of the operating deficit due to lower inspection fees. Non-operating revenue decreased \$25,749 due to lower interest rates and lower cash balances available for investment. Operating expenses increased \$3.3 million, or 3.9% most of this increase (\$3.1 million) was in the Corrections Center, with a small increase in Fire Services and a small decrease in Consolidated Codes enforcement.

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 assets of \$87.8 million. The County's governmental activities operated with an increase in net assets of \$87.6 million. The business-type activities had a net increase of \$0.2 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. Readers will notice a change in the classifications of fund balances within the governmental funds from previous years. The County chose to implement a new financial accounting standard for FY 2010 (GASB Statement No. 54). This standard establishes 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 restricted, committed, assigned and unassigned. More details on these classifications are presented in the Notes to Financial Statements I (E) under “Net Assets and Fund Equity.”

As of the end of the current fiscal year, Shelby County’s governmental funds reported a combined ending fund balance of \$335,414,600. The components of the balances are:

	June 30, 2011	June 30, 2010
General Fund	\$ 86,867,384	\$ 78,157,913
Debt Service Fund	107,814,958	102,529,235
Special Revenue Funds	527,941	11,157,276
Total, except Capital Projects Fund	195,210,283	191,844,424
Capital Projects Fund	140,204,317	101,339,609
Total all governmental funds	<u>\$ 335,414,600</u>	<u>\$ 293,184,033</u>

There was a \$3.4 million net increase in fund balance excluding capital projects. There was an increase of \$8.7 million in the General Fund, an increase of \$5.3 million in the Debt Service Fund and a decrease of \$10.6 million in all special revenue funds. There was also an increase of \$38.9 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 \$8.7 million, compared to a net increase of \$3.0 million in the previous year. The General Fund had an increase in revenue of \$9.5 million, with an increase of \$15.7 million in property taxes and decreases in several other revenues. General Fund expenditures and other financing sources/uses (mostly transfers out) increased \$2.8 million. The General Fund also had an extraordinary loss of \$1.0 million. The General Fund unassigned fund balance increased \$9.9 million to \$85.6 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 23.26% of total General Fund

revenue. Management is committed to maintaining an unassigned fund balance in the General Fund of 15% to 25% of General Fund revenue.

The Debt Service Fund has a total fund balance of \$107.8 million, all restricted or committed for the payment of debt service. The net increase in fund balance during the current year was \$5.3 million, compared to \$27.9 million the previous year. Revenue decreased \$9.5, mostly from decreased property taxes that were shifted to the General Fund. The Debt Service fund balance is 58.7% of the current year expenditures.

The fund balance of the Capital Projects Fund fluctuates significantly as funds are borrowed for capital project purposes and are then expended for the projects. This fund balance increased \$38.9 million, from \$101.3 million to \$140.2 million. The increase in fund balance was primarily the result of a \$67.3 million loan from the State of Tennessee under the Qualified School Construction Bond Program, less expenditures made from the loan proceeds during the year. The proceeds of this loan will be paid to the Shelby County and Memphis City school systems as they expend funds for capital projects. All fund balances of the Capital Projects Fund are restricted, committed or assigned.

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. The Education Fund, a special revenue fund, had an ending fund balance of \$9.1 million at the end of the previous year. This balance resulted from more property tax revenue during the year than the expenditure appropriation to the Shelby County and City of Memphis school systems. The fund balance plus all current year revenue was paid to the school systems during the current year. There was a zero fund balance at June 30, 2011.

The Grant Fund balance decreased further from a deficit of \$15.5 million at June 30, 2010 to a deficit of \$16.2 million at June 30, 2011. These negative fund balances are caused by receivables not being paid by sponsors/grantors in time to be considered "available" in the current year. Other special revenue funds had a net decrease in fund balances during the year of \$0.8 million as slightly more was expended than received. Significant balances at year-end, all positive and all restricted, include \$2.8 million in the Health Services Restricted Fees Fund, \$5.6 million in the Roads and Bridges Fund and \$6.2 million in the Sheriff Forfeitures 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, economic conditions have resulted in a reduction in construction activities resulting in much lower codes enforcement fees, requiring shared support from the County's general fund and the City of Memphis. During this fiscal year \$1.7 million was transferred from the General Fund and \$1.7

million was contributed by the City to maintain the net asset balance of \$2.2 million, of which only \$0.6 million is unrestricted. The Fire Services Fund operates entirely on user fees; the net asset balance decreased slightly during this fiscal year by \$277,025 to a balance of \$5.3 million, of which \$2.7 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 \$0.6 million in net assets to a balance of \$31.3 million, of which \$11.2 million is unrestricted. Overall the net assets of the enterprise funds increased by \$0.4 million during the year with total net assets at year-end of \$38.8 million, of which \$14.5 million was unrestricted. Unrestricted net assets increased 3.4% or \$0.5 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, 2011 these funds combined had net assets of \$18.4 million, a decrease of \$0.4 million. The Group Health Insurance Fund had a decrease of \$2.0 million in net assets to total net assets of \$7.3 million. The Employer Insurance Fund had a decrease of \$149,922 to total net assets of \$5.0 million. At year-end the Central Services Fund had net assets of \$2.4 million and the Tort Liability Fund had net assets of \$3.7 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 at June 30, 2011 were 89.9% 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, 2011 the Retirement System had net assets held in trust of \$982,539,680.

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, 2011 the Trust had net assets held in trust of \$88.2 million. The ratio of current funding to the actuarial liability improved from 15.1% to 19.1% during the past year.

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:

- Differences between the original and final amended budgets for revenue and expenditures were insignificant in total (less than .05%). The expenditure variations largely reflect allocations of the salary and O&M restrictions from central operations to the divisions where surplus amounts were realized.
- Actual revenues exceeded the final budget by \$5.9 million – about 1.6% more than the budgeted level. Stronger property tax collections than projected accounted for \$2.4 million of that amount – about 1% higher than budget. An additional \$3.4 million was

collected in fines, fees and permits (6% above budget) by the courts and the Trustee. An unfavorable variance of \$1.2 million in investment income reflects continued low interest rates.

- Actual expenditures were \$9.2 million (almost 2.6%) below the amended budget. Significant personnel savings (\$6.6 million) resulted from an ongoing hiring freeze and the elimination of 75 vacant positions during the year. Savings of \$2.6 million were also realized from cutbacks and cost containment efforts in most operating account categories.

Capital Asset and Debt Administration

Capital assets. Shelby County Government's investment in capital assets for its governmental and business type activities at the end of the current fiscal year amounts to \$570.8 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 \$22.0 million and depreciation was \$27.1 million. Construction in progress as of the end of the current fiscal year was \$21.2 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 2011 the County provided capital improvement funding of approximately \$29.4 million to the Memphis and Shelby County school systems.
- Roadway improvements and drainage improvements continued within the County with expenditures of approximately \$1.0 million.
- Renovation work continued on the Shelby County Office Building at 157 Poplar Avenue; expenditures on this renovation were approximately \$3.8 million.
- Renovation work continued on the Cotton Creek Sewer System, with expenditures of approximately \$0.2 million.
- Expenditures for obtaining and implementing an integrated system to maintain, share and track personal health records for inmates and others were \$0.8 million.

Long-term debt. At June 30, 2011 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,665,674,209, which represented approximately 8.7% of assessed value of taxable property. The County's bonds, loans and notes payable decreased by approximately \$41.6 million (2.5%) 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 generally uses a notes payable program 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. During FY 2011 no short-term notes were issued or outstanding.

During FY 2011 the County entered into an agreement with the State of Tennessee. The State issued \$67,260,000 of bonds under the federal Qualified School Construction Bonds Program and loaned the proceeds to the County. The County is making the funds available to the Shelby County and City of Memphis schools for specific capital projects. The County will repay the State over the life of the bonds. Since the loan is a general obligation of the County and is backed by the full faith and credit and unlimited taxing power of the County, the County is reporting the loan with other long-term debt.

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

The September 2011 unemployment rate for Shelby County was 10.8%, which compares to the rate of 9.8% for the State of Tennessee and 9.1% for the nation. General economic conditions in the region have been parallel to those across the nation.

The total property tax rate for the FY 2012 budget was maintained at the same level as FY 2011, with some adjustments to fund allocations within that rate. Considering the ongoing challenges in the real estate market a reduction in property taxes of 2% has been forecasted for fiscal 2012. The budgeted level for FY 2012 is 2% less than actual collections for FY 2011.

Total General Fund revenue for FY 2012 is projected at 1% less than the FY 2011 budget and about 2.5% less than actual receipts for FY 2011. The reduction is attributed primarily to shifting the FY 2012 budget for the county share of local sales tax from the General Fund to the Debt Service Fund in relation to an economic development project. General Fund expenditures have been reduced in total by about 2% compared to prior year. Factors contributing to control of personnel expense for FY 2012 included deferral of employee pay raises, adjustments to pension and health benefit plans, the continuation of a hiring freeze implemented in FY 2009 as a means of evaluating staffing priorities, and the elimination of 75 positions through attrition. A significant reduction also resulted from an agreement with the Regional Medical Center to forgo additional funding of \$10 million previously necessary to sustain their operations. The County Mayor and Commission are committed to holding General Fund expenditures at the same level as projected General Fund revenue growth.

Debt service expenditures increased \$11.5 million in FY 2011, mainly as a result of the County's participation in the Qualified School Construction Bond Program. Expenditures in FY 2012 are budgeted to decrease slightly compared to the final FY 2011 budget. Projections based on the County's five-year capital plan indicate debt service expenditures will slowly decline in future years. The County plans to maintain annual capital expenditures at \$75 million or less.

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 1150, Memphis, Tennessee 38103.