

### 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, 2007. We encourage readers to consider the information presented here in conjunction with information in the transmittal letter found at the front of this report and the basic financial statements, which follow in this section.

Accounting principles generally accepted in the United States of America for governmental entities are established by the Governmental Accounting Standards Board (GASB). This annual financial report uses the standards established by the GASB's Statement No. 34 *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Shelby County follows all GASB standards in addition to Statement No. 34 as well as other authoritative literature known collectively within the accounting profession as "generally accepted accounting principles."

### Financial Highlights

- At the end of the current fiscal year, unreserved fund balance for the general fund was \$47,178,094, or 14.4% of total general fund expenditures. This was an increase of \$6.0 million or a 14.7% increase.
- In addition to the general fund balance increase noted above, the County also by transfer from the general fund increased the pay-as-you-go capital projects fund by \$11.8 million.
- Fund balance for the debt service fund increased \$7.5 million to \$63,401,912, which is 40.0% of total expenditures of the debt service fund. The balance is well above our target minimum level of \$4 million and consistent with our plan to provide now for increasing debt service requirements through 2012.
- Total liabilities of Shelby County exceed total assets as of June 30, 2007 by \$963,962,911. The largest contributing factor causing this deficit is the fact that the County issues debt on behalf of entities not a part of the County's primary financial reporting unit and the related assets are not recorded by the County. These entities include the school systems of Shelby County and the City of Memphis, joint ventures with the City of Memphis, and others. Debt for these entities as of June 30, 2007 was \$1,370,230,562.
- Total government-wide net assets increased \$26.4 million primarily as a result of the fund balance increases noted above in the general fund and debt service fund and a \$9.7 million increase in the net assets of the internal service funds.

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 (Budgetary Comparison Schedules)
- Combining Statements and Individual Fund Statements and Schedules

#### BASIC FINANCIAL STATEMENTS

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

The *statement of net assets* presents information on all of Shelby County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of changes in the financial position of Shelby County. However, because the County issues substantial amounts of debt for capital assets of others, such as the Memphis City Schools, annual decreases in net assets are expected in years when such debt is issued.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying economic event giving rise to the change occurs, *regardless of the timing of related cashflows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of Shelby County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of Shelby County include general government, hospital, planning & development, public works, corrections, health services, community services, law enforcement, judicial, other elected officials, education and

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

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

**Fund financial statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Shelby County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Shelby County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is more narrow than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

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

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

Shelby County uses internal service funds to account for its central services, group hospital, group life, 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, only in more detail. The proprietary fund financial statements provide separate information for each enterprise fund. Internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of a *combining statement* elsewhere in this report.

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

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

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

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. "Notes" is the traditional term applied to this information; however the term is misleading in that the notes can vary in length from one paragraph to several pages.

**REQUIRED SUPPLEMENTARY INFORMATION**

This section contains other information that financial reporting standards specify should be included under this caption. Shelby County is 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 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, 2007). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2007 and as of June 30, 2006.

Property taxes receivable is by far the largest portion of Shelby County's assets (43.7% at June 30, 2007 and 45.7% at June 30, 2006). The June 30, 2007 property taxes receivable includes \$698.1 million, offset by an equal deferred revenue amount in other liabilities, which became a property lien on January 1, 2007 but are levied for next fiscal year's operations. The similar amount at June 30, 2006 was \$688.4 million. Total assets increased \$99.8 million, attributable primarily to an increase in the total of cash and cash equivalents and investments (\$98.3 million). This increase resulted primarily from about \$60 million of proceeds of debt issued for capital projects not being expended as of June 30, 2007, the transfer of \$11.8 million to the capital projects fund as of June 30, 2007 and the increase in fund balance in the general fund and debt service fund.

Liabilities increased \$73.4 million during the year. This increase was due primarily to a net increase of \$70.2 million in long-term debt.

Table 1  
Condensed Statement of Net Assets  
As of June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 745,228,799	\$ 734,035,950	\$ 11,192,849
Current and other assets	348,332,759	258,225,960	90,106,799
Capital assets	568,980,051	572,933,781	(3,953,730)
Total assets	1,662,541,609	1,565,195,691	97,345,918
Long-term liabilities	1,869,575,410	1,799,887,983	69,687,427
Other liabilities	791,662,585	788,278,259	3,384,326
Total liabilities	2,661,237,995	2,588,166,242	73,071,753
Invested in capital, net of related debt	157,206,332	156,764,887	441,445
Restricted	91,417,704	80,104,201	11,313,503
Unrestricted	(1,247,320,422)	(1,259,839,639)	12,519,217
Total net assets	(998,696,386)	(1,022,970,551)	24,274,165
<u>Business-Type Activities</u>			
Current and other assets	13,809,099	11,354,202	2,454,897
Capital assets	27,908,007	27,935,169	(27,162)
Total assets	41,717,106	39,289,371	2,427,735
Long-term liabilities	5,608,117	5,052,493	555,624
Other liabilities	1,375,514	1,600,569	(225,055)
Total liabilities	6,983,631	6,653,062	330,569
Invested in capital, net of related debt	26,737,011	27,213,452	(476,441)
Unrestricted	7,996,464	5,422,857	2,573,607
Total net assets	34,733,475	32,636,309	2,097,166
<u>Total Primary Government</u>			
Property taxes receivable	745,228,799	734,035,950	11,192,849
Current and other assets	362,141,858	269,580,162	92,561,696
Capital assets	596,888,058	600,868,950	(3,980,892)
Total assets	1,704,258,715	1,604,485,062	99,773,653
Long-term liabilities	1,875,183,527	1,804,940,476	70,243,051
Other liabilities	793,038,099	789,878,828	3,159,271
Total liabilities	2,668,221,626	2,594,819,304	73,402,322
Invested in capital, net of related debt	183,943,343	183,978,339	(34,996)
Restricted	91,417,704	80,104,201	11,313,503
Unrestricted	(1,239,323,958)	(1,254,416,782)	15,092,824
Total net assets	\$ (963,962,911)	\$ (990,334,242)	\$ 26,371,331

“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, 2007	June 30, 2006
Shelby County and City of Memphis schools	\$ 1,155,445,388	\$ 1,052,751,140
Shelby County Health Care Corp. (component unit)	82,850,560	105,785,458
Convention Center (joint venture)	73,062,007	76,322,265
Other	58,872,608	61,711,855
Total	\$ 1,370,230,562	\$ 1,296,570,718

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 \$26.4 million. The significant reasons for this increase can be generally understood from information in the section “Financial Analysis of the Government’s Funds” below. Excluding the increase in debt for which the related capital assets are not recorded by Shelby County (schedule above) of \$73.7 million, the County’s total net assets increased by \$100.1 million. 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, 2007, with comparative amounts for the fiscal year ending June 30, 2006.

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. In FY 2007 \$29.8 million of revenues were classified as other taxes that in FY 2006 were classified as program revenue. Program revenues decreased only \$1.0 million when the reclassification is considered. General revenues increased \$36.1 million other than the reclassification, or 4.7%; of this, \$26.1 million was from property tax increases and \$10.5 million from other general revenue. Overall revenues increased \$35.1 million or 3.5% during the year.

Table 2  
Shelby County Change in Net Assets  
Fiscal Years Ended June 30, 2007 and 2006

	FY 2007	FY 2006	Change
<b>Governmental activities:</b>			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 91,277,341	\$ 96,032,811	\$ (4,755,470)
Operating grants and contributions	121,125,431	138,189,459	(17,064,028)
Capital grants and contributions	3,440,619	12,460,564	(9,019,945)
Total program revenues	215,843,391	246,682,834	(30,839,443)
General revenues:			
Property taxes	680,615,376	654,551,938	26,063,438
Other taxes	124,690,522	95,321,849	29,368,673
Other	24,575,622	14,068,619	10,507,003
Total general revenues	829,881,520	763,942,406	65,939,114
Total revenues-governmental activities	1,045,724,911	1,010,625,240	35,099,671
<u>Expenses:</u>			
General government	48,815,450	32,850,485	15,964,965
Hospital	27,566,667	25,566,667	2,000,000
Planning & Development	6,133,345	6,558,085	(424,740)
Public Works	52,071,835	49,927,770	2,144,065
Corrections	928,659	505,384	423,275
Health Services	57,842,725	53,781,890	4,060,835
Community Services	42,808,278	43,060,057	(251,779)
Law Enforcement	138,231,040	130,666,941	7,564,099
Judicial	74,919,142	71,267,471	3,651,671
Other Elected Officials	25,988,417	24,573,915	1,414,502
Education	451,071,817	446,365,688	4,706,129
Interest on debt	87,802,538	83,880,247	3,922,291
Total expenses-governmental activities	1,014,179,913	969,004,600	45,175,313
Increase (decrease) in net assets before transfers	31,544,998	41,620,640	(10,075,642)
Transfers	(7,270,833)	(5,276,913)	(1,993,920)
Increase (decrease) in net assets	24,274,165	36,343,727	(12,069,562)
Net assets - beginning of year	(1,022,970,551)	(1,059,314,278)	36,343,727
Net assets - end of year	\$ (998,696,386)	\$ (1,022,970,551)	\$ 24,274,165

Total expenses for the year in governmental activities increased \$45.2 million (4.7%). Over one-half of the increase was the result of across-the-board salary increases and fringe benefit increases. Other increases were an increase of \$3.9 million in interest on debt, an increase of \$4.7 million in funds provided to the two school systems, an increase of \$2.0 million in funds provided to The Med (Hospital) and program cost increases in other functional areas, especially health services and law enforcement. The increase in general government was primarily caused



by more accurate allocation to all functional areas of certain adjustments from the funds to entity-wide perspective.

	FY 2007	FY 2006	Change
<b>Business-type activities:</b>			
<u>Revenues:</u>			
Operating revenues:			
Charges for services	\$ 65,377,640	\$ 62,525,770	\$ 2,851,870
Operating grants and contributions	49,050	43,050	6,000
Total operating revenues	65,426,690	62,568,820	2,857,870
Non-operating revenues	525,358	374,704	150,654
Total revenues	65,952,048	62,943,524	3,008,524
<u>Expenses:</u>			
Operating expenses	70,343,705	66,486,101	3,857,604
Non-operating expenses and losses	782,010	726,024	55,986
Total expenses	71,125,715	67,212,125	3,913,590
Increase (decrease) in net assets before transfers	(5,173,667)	(4,268,601)	(905,066)
<u>Transfers</u>	7,270,833	5,276,913	1,993,920
Increase (decrease) in net assets	2,097,166	1,008,312	1,088,854
Net assets - beginning of year	32,636,309	31,627,997	1,008,312
Net assets - end of year	34,733,475	32,636,309	2,097,166
<b>Total primary government:</b>			
Increase (decrease) in net assets	26,371,331	37,352,039	(10,980,708)
Net assets - beginning of year	(990,334,242)	(1,027,686,281)	37,352,039
Net assets - end of year	\$ (963,962,911)	\$ (990,334,242)	\$ 26,371,331

In business-type activities, total revenues increased by \$3.0 million. Of this increase, \$2.0 million was in corrections center reimbursement for housing State inmates, \$.9 million in fire services from increase in fire fees and consolidated codes had a small (\$.1 million) increase. Expenses increased by \$2.3 million for the corrections center and \$1.4 million for fire services. Corrections center net transfers in increased by \$1.4 million.

#### CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during fiscal year 2007 was an increase in net assets of approximately \$26.4 million.

The County's governmental activities operated with an increase in net assets of approximately \$24.3 million. Net assets restricted for debt service increased by \$7.5 million that was a planned increase to accumulate funds for increased debt service requirements in the next few years. Net assets of special revenue funds increased by \$3.8 million, mostly in the hotel/motel tax fund and the Sheriff narcotics fund. Unrestricted net assets increased by \$12.5 million; this increase resulted primarily from planned increases in the general fund unreserved balance of \$6.0 million

and a planned increase in the group health insurance internal service fund of \$9.3 million to position the County to better handle OPEB expenses in future years.

The business-type activities had a net increase of \$2.1 million. This resulted from increases in fire services (\$2.1 million) and the corrections center (\$2.6 million), offset by a planned reduction in net assets of consolidated codes enforcement (\$2.6 million).

### Financial Analysis of the Government's Funds

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

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

As of the end of the current fiscal year, Shelby County's governmental funds reported a combined ending fund balance of \$240,446,456. The components of the balances are:

	June 30, 2007	June 30, 2006
General Fund-reserved/designated	\$ 4,119,786	\$ 4,150,637
General Fund-unreserved	47,178,094	41,147,243
Debt Service Fund	63,401,912	55,924,980
Special Revenue Funds	28,015,792	24,179,221
Total, except Capital Projects Fund	142,715,584	125,402,081
Capital Projects Fund	97,730,872	28,418,919
Total all governmental funds	<u>\$ 240,446,456</u>	<u>\$ 153,821,000</u>

There was a \$17.3 million increase in fund balance excluding capital projects. Of this increase \$6.0 million was in the unreserved balance in general funds, \$7.5 million was in the debt service fund and \$3.8 million was in the special revenue funds. There was also an increase of \$69.3 million in the capital projects fund. Each of these changes is discussed below.

The general fund operated with net revenue of \$6.0 million, resulting primarily from tax revenues being somewhat higher than projected, offset by the County deciding to transfer \$11.8 million to the capital projects fund to reduce future debt requirements. The general fund unreserved amount is available for spending at the government's discretion. The remainder of fund balance has been committed to liquidate contracts and purchase orders of the prior period and for advances to the fire services fund.

The general fund is the chief operating fund of Shelby County. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 14.4 percent of total general fund

expenditures, while total fund balance represents 15.7 percent of that same amount. General fund revenues were \$16.1 million (4.8%) above the prior year, which resulted primarily from increased local taxes and State revenues. Expenditures were \$17.8 million more (5.8%) than the prior year and net transfers out were \$4.1 million less. Before the beginning of FY 2006 management committed to maintaining an unreserved fund balance of the general fund of at least 12.5% of general fund expenditures.

The debt service fund has a total fund balance of \$63,401,912 to be used for the payment of debt service. The net increase in fund balance during the current year was \$7,476,932. This increase was planned to somewhat smooth out the revenue requirements in future years as debt service requirements reach a peak projected amount in 2012.

The fund balance of the capital projects fund improved from \$28,418,919 to \$97,730,872. This was primarily the result of issuing long-term debt for capital improvement projects of \$140.4 million, of which \$60 million had not been expended as of June 30, 2007. In addition, \$11.8 million was transferred from the general fund as of June 30, 2007 to be used for capital projects reducing future requirements to issue debt.

All special revenue balances are available only for the specific purposes designated by the provider of the funds or the legislation establishing the fees and charges that generate the revenue. Total fund balances of these funds increased to \$28.0 million at June 30, 2007 compared to \$24.2 million at June 30, 2006. Significant balances include \$3.5 million in the grants fund, \$9.2 million in the roads and bridges fund, \$6.7 million in the hotel/motel tax fund and \$5.2 million in the Sheriff narcotics fund.

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

The County has three business-type activities; these are essentially self-supporting activities. Two of the activities have consistently been able to support themselves; these are the consolidated codes enforcement fund and the fire services fund. However, starting in FY 2005 a management decision was made to spend down the net asset balance in the consolidated codes enforcement fund. During this fiscal year the net asset balance decreased by \$2.6 million to a balance of \$4.8 million. The fire services fund operates entirely on user fees; the net asset balance increased during this fiscal year by \$2.1 million to a balance of \$3.9 million. 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. Unrestricted net assets of the enterprise funds at the end of the year amounted to \$7,996,464, an increase of 47.5%.

Total net assets of the enterprise funds increased \$2,097,166, or about 6.4%, during the year. This increase resulted from increases in fire services and corrections center revenue, offset by the planned use of fund balance in the consolidated codes enforcement fund.

The County has five 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, 2007 these funds combined had net assets of \$30,332,845, an improvement of \$9,735,502 over the balance of \$20,597,343 from the prior year. The increase in fund balance was primarily in the group hospital insurance fund. The employer insurance fund had a deficit at June 30, 2006 of \$959,015; this was improved to a positive balance of \$504,628 at June 30, 2007. The group life insurance fund was closed during FY 2007 as a result of changing from self-insured to a commercial insurance plan.

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

The 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 for the general fund can be briefly summarized as follows:

- The revenue budget was increased during the year by \$15.5 million, or 4.7% from the original budget. Property taxes revenues account for \$7.9 million of that increase; other local taxes and elected officials' fines and fees were increased by an additional \$3.1 million and \$2.5 million, respectively.
- Actual revenues exceeded the revised budget estimate by \$3.7 million, or 1.1%. Other revenues, including investment income, accounted for \$3.2 million of that favorable variance. State revenues exceeded budget by \$2.1 million, reflecting favorable collections of State income and TVA replacement taxes.
- The overall expenditure budget was increased during the year by \$2.9 million, or about nine-tenths of one percent. Increases were necessary to fund market study salary adjustments and utilities; other changes reflected adjustments shifting anticipated salary lapse and restriction budgets to the programs where they were realized.
- Actual expenditures were \$2.9 million below the amended budget, a savings of about nine-tenths of one percent. Most of the savings were attributed to reduced expenditures in operating and maintenance accounts (\$1.9 million) rather than salaries (\$.8 million).
- The budget for net transfers out was increased by \$13.0 million, primarily reflecting additional transfers to the CIP fund for pay-as-you-go capital projects (\$11.8 million) and to

the economic development fund (\$1.0 million).

### 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, 2007 amounts to \$596.9 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 \$30.9 million, depreciation was \$28.1 million and disposals were \$6.8 million, for a net decrease of \$4.0 million. Construction in progress as of the end of the current fiscal year was \$25.6 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:

- Roadway improvements, drainage improvements, and sanitary sewer upgrades continued within the County with an estimated cost of \$6.0 million.
- Renovation work continued at the Criminal Justice Complex, with completion of projects including centralization of the floor pod control, jail door retrofit, and jail control center.
- Although not recorded as assets of the County, during FY 2007 the County provided capital improvement funding of \$90.0 million to the two school systems.

**Long-term Debt.** At June 30, 2007 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,820,107,969 which represented approximately 10.4% of assessed value. The County's bonds and notes payable increased by approximately \$57 million (3.2%) during the year. Debt, generally, may be issued without regard to any limit on indebtedness. The ad valorem tax levy is also without legal limit.

The County uses notes payable programs to initially finance capital projects. This allows the County to borrow only as the proceeds are actually needed and to take advantage of lower short-term interest rates. Annually, the County adopts a five-year capital projects plan. Based on this plan for the current year and capital projects cash flow projections, a notes payable program is established with a maximum borrowing amount. Borrowing occurs as needed for up to two years. After completion of each program, the notes payable are converted to bonds payable to be repaid within 25 years. On March 28, 2005 the County authorized the issuance of \$275 million of extendible municipal commercial paper ("EMCP"). In February 2006 the County refunded and ultimately retired \$135 million of issued EMCP and in December 2006 the County refunded and retired the outstanding \$140 million issued EMCP.

At the end of FY 2006 the County transferred \$13.9 million into a pay-as-you-go account in the capital improvements fund. An additional \$11.8 million was transferred into the account in FY 2007. This process should reduce future long-term debt related to capital projects.

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

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

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

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

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

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

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

- The October 2007 unemployment rate for Shelby County was 4.6 percent, the same as the State's rate and compared to the national rate of 4.7%.
- Inflationary trends in the region compare favorably to national indices.
- There has been some increase in foreclosure rates that appears to be related to sub-prime lending issues and there are concerns regarding the impact on property taxes.

For 2008 the property tax rate was maintained at the same amount as 2007. Compared to actual revenue for 2007, we have budgeted no growth in property taxes for 2008.

For fiscal year 2008 general fund revenue growth is budgeted to be 2.9% over the 2007 budget. Actual revenue for 2007 exceeded the amount budgeted so that no growth in actual revenue will be necessary to reach the budget. General fund expenditures were also budgeted to increase by

7.7% compared to 2007. A planned use of fund balances has been budgeted of \$3 million for 2008 primarily to provide additional funding for Juvenile Court; however, we expect to be able to offset this by a combination of additional revenue and expenditure reductions so that there will not be an actual use of fund balance. The County Mayor and Commission are committed to holding general fund expenditures in line with general fund revenue growth. With a substantial portion of the County incorporated and annexations decreasing the unincorporated area, County government is shifting responsibilities to the cities and focusing on our primary mission of education, criminal justice and health. However, the increase in budgeted expenditures above the budgeted revenue growth is primarily due to an increase in health insurance, utility costs, the jail medical contract and other post employment benefits. A consulting firm was engaged in 2004 to perform an efficiency study and assist us in preparing a five year strategic plan which was completed in October 2004. Substantial efficiencies have been identified and implemented. In 2007, we are updating the efficiency study and five year strategic plan.

Because of the school capital needs and converting notes payable to long term-debt to take advantage of low interest rates, debt service expenditures are increasing \$8.7 million in 2008. Debt service requirements will continue to increase for the next several years because of the school funding commitment previously noted and the current debt structure. However, various steps are being taken to move towards ending the growth of debt and the debt service requirements. Capital outlays have been reduced from \$154 million in 2002 to \$108 million in 2007. The five-year capital improvement plan was updated with reductions in new debt requirements except an additional \$50 million commitment for schools which is expected to be paid in 2008. Starting in 2009, the capital improvement plan provides for expenditures of approximately \$75 million per year.

### **Requests for Information**

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