



Shelby County Government

A C Wharton, Jr.
Mayor

December 17, 2007

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, 2007 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, 2007. 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 905,705. The County is empowered to levy, without limit, a property tax on both real and personal property located within its boundaries.

Since the implementation of the Restructure Act on January 1, 1976, the County has operated 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 early March. After a series of reviews, the County Mayor presents a proposed consolidated budget to the County Commission by April 30. 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 growth in the local economy this past year as did most of the country. In recent years, the economy of the County has experienced notable success attracting new businesses along with the continued growth of existing businesses. Shelby County experiences relatively steady total employment during periods of sluggish growth or decline in the national economy with substantial increases when the national economy improved. This is due, in large part, to the County's location near the geographic center of the nation and its excellent transportation facilities. Also, the County benefits from serving as the trade center for the surrounding area and benefits from a broad industrial and commercial base, as noted below.

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, 2007 was 4.8%, as compared to the state's rate of 4.7% and the national rate of 4.7%.

Long-term financial planning

During the past ten years, excluding capital projects, the County's governmental expenditures related to education, law enforcement and debt service have increased as a percent of total expenditures from 60.0% to 67.4%. Education expenditures increased from 34.6% to 36.8%.

During this same ten-year period, local taxes have increased as a percent of total revenue from 67.1% to 74.5% because the areas of relative increase in expenditures are primarily supported by local taxes. As a percent of total revenue, State and Federal revenue has decreased from 13.7% to 12.9%, elected officials fees and fines have decreased from 9.0% to 6.3% and all other revenues have decreased from 10.2% to 6.3%. Most fees and fines as well as some of the other revenues are set by the State and are not regularly increased to provide for inflationary cost increases.

In 2003, the Mayor, with the support of the Commission, made it a priority to replenish and then maintain the General Fund unreserved fund balance as a percent of General Fund expenditures between 10% and 15%. This percentage has increased each of the last four years and is 14.4% as of June 30, 2007.

In 2004, the Administration, with the support of the Commission engaged Public Financial Management, Inc. (PFM), a financial advisory firm, to conduct a study to determine whether Shelby County Government is operating efficiently and effectively. The result of this study was the issuance of a five-year strategic financial and management plan. The study found that Shelby County Government is relatively efficient compared to similar governments, but it also highlighted a number of areas for improvement. All of the recommendations have been addressed and many were implemented. Working with PFM we have recently updated the five-year strategic financial and management plan.

Closer cooperation has been established 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. 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 debt peaked at \$1.85 billion and it has declined to \$1.78 billion as of June 30, 2007. We expect a slow steady decline in future years as long as we adhere to our capital plan. However, the City and County School Systems have identified needs well beyond the amounts provided in our capital plan. Through growth management and needs assessment as addressed below, school needs will be more clearly identified and alternative funding sources may be established. Should any increase to the capital plan be necessary, funding must also be provided. The Sheriff has indicated a need for additional jail capacity and that an improved design of any new capacity along with changing the utilization of the current jail could result in cost savings through staff reductions to offset the annual debt service on the cost to provide additional capacity.

Major initiatives

The Administration has identified a number of priorities designed to shore up 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. Update of Development Regulations/Equitable Growth Strategy** – The Mayor's Alliance for Equitable Growth has set a precedent for shifting the county's growth and development

patterns. Equitable growth will allow the county to protect the environment, reinvest in urban areas, bring economic opportunity to all residents, provide for intelligent infrastructure investment and stimulate housing choices. Under the Mayor's direction, Shelby County is drafting smarter development regulations that will curtail suburban sprawl and help develop Shelby County as a better community.

A joint city and county partnership, the unified development code's goal is to promote inner city redevelopment and revitalization while guiding orderly growth in the suburban areas in a fiscally sound manner.

- 2. Education, Capital Needs & Fiscal Analysis** – The County established a Needs Assessment Committee to address the financial burden of the current capital funding mechanism for public schools, including both Memphis City Schools and Shelby County Schools. The Committee will: 1) Develop uniform standards and costs for school construction; 2) Annually assess capital needs of each school system and create a comprehensive plan for capital projects and funding; and 3) Review, as necessary, capital requests of both school systems that fall outside of the comprehensive plan and make recommendations to the County Commission regarding those requests.

Part of equitable growth includes guiding the construction of new schools to achieve maximum performance and fiscal advantage out of each school. Involved in the development of new schools is the fiscal impact model update. The model measures the impact of each new development on a community to determine facts like how many school age children will live there and how many roads and parks are necessary.

- 3. Children, Youth and Families** – Shelby County is home to almost 20% of Tennessee children under age 18. Almost 40% of Shelby County households include a child under age 18. Fully half of every County property tax dollar collected goes to education funding, yet the County has no influence over education policy nor does it have a dedicated presence for child and family policy issues as a whole. Shelby County recognizes the need to develop a partnership to be tasked with providing a unified point of collaboration for programs, services and policies related to children, youth and families in the community. This partnership will leverage the political influence of the Shelby County Mayor and Shelby County Board of Commissioners to foster collaboration and partnership among existing and proposed services. It will serve as an advisor to County government on policies and issues related to children and youth; work to raise community awareness about the impact of policies and decisions on children and youth; maximize community-wide effectiveness and impact of existing programs and agencies through linkages and collaboration; and incubate ideas and innovations that can improve the lives of children, youth and families in Shelby County.
- 4. Economic Development** – One of the County's primary advantages for economic development is the combination of its central location in the United States and its excellent transportation facilities, including air, rail and water. Another advantage is the relatively low cost of living compared with other urban areas, including real estate prices. In order to build on these natural assets and recognizing that the local governments must take a leadership role in economic development, the City and County governments formed a new "Mayor's Office of Economic Development" and, after a nation wide search, have selected a new Director to lead this office.

Further, in conjunction with the City, Memphis Tomorrow (a group of leading CEO's) and the Chamber of Commerce, the County is embarking on a broad economic growth initiative

called *Memphis Fast Forward*. In addition to the specific component for economic development, this initiative includes strategic plans for education/workforce development; public safety and government efficiency. It is our intent to aggressively move over the next five years to become the major economic center of the Southern United States and a place where economic prosperity is available to all our residents.

- 5. Parks and Natural Resources** – The protection of Shelby Farms, the development of a cohesive greenbelt and the protection of a strong natural water supply are three important steps in making Shelby County an environmentally responsible community and an attractive destination for outdoor enthusiasts.

Nearly four times larger than New York’s Central Park, Shelby Farms is a recreational gem for families, athletes and sportsmen. To preserve this 4,000 acre park for future generations, the County has transferred Shelby Farms to a conservancy and Mayor Wharton is leading a coalition of citizens and government planners to develop a 50-year master plan. The plan will preserve the park’s integrity and make it more functional for community enjoyment.

Shelby County’s natural rivers and streams attract the community’s nature lovers from both urban and suburban dwellings. Using federal, state and local funding, the County is working to create a cohesive greenbelt that protects the natural areas and connects the County’s communities from downtown Memphis to Collierville, Frayser and all points in between.

Being able to enjoy clean drinking water is a given for Shelby County and its residents. The county sits on one of the largest artesian ground water supplies in the world and the area’s abundant supply of naturally pure water has fueled the local economy for a century. Through the Memphis Regional Groundwater Study, Shelby County is using federal funds to ensure water quality is protected and sustained.

- 6. The Regional Medical Center at Memphis (The Med)** – In recognition of the critical role of the Med as the provider of vital health care services, but limited by available resources, the Mayor convened a blue ribbon task force to develop long and short term strategies for the continued operation of the Med. This panel concluded that it was essential to the community that the Med maintain its core service mission. However, the panel also acknowledged that the financial requirements to do so were so severe that the exploration of new structures for the provision of health care, including partnerships, collaborations or affiliations with other providers would be necessary. We are working with the State and engaged a consultant to assist in soliciting interest in some type of affiliation for the Med.

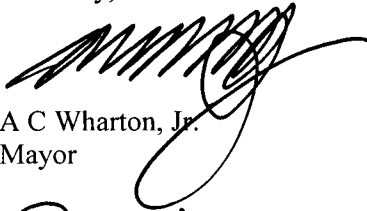
Awards and Acknowledgements

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, 2006. This was the twenty-second 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.

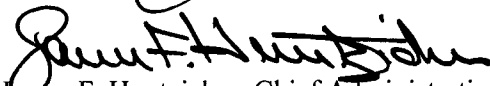
A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

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,

A handwritten signature in black ink, appearing to read 'A C Wharton, Jr.', with a large, stylized flourish extending from the end of the signature.

A C Wharton, Jr.
Mayor

A handwritten signature in black ink, appearing to read 'James F. Huntzicker', with a large, stylized flourish extending from the end of the signature.

James F. Huntzicker, Chief Administrative Officer and
Director of Division of Administration & Finance