

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, 2005. 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 is the fourth annual financial report issued by Shelby County using the standards established by the GASB's Statement No. 34 *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Statement No. 34 made significant changes to financial reporting, including new "government-wide" financial statements. 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 undesignated fund balance for the general fund was \$37,539,543, or 12.5 percent of total general fund expenditures. This was an increase of \$7,358,304, or a 24.4% increase.
- Fund balance for the debt service fund increased \$19.8 million to \$29,241,588, which is 21.7% of total expenditures of the debt service fund. The balance is well above our target minimum level of \$4 million.
- Total liabilities of Shelby County exceed total assets as of June 30, 2005 by \$1,364,376,086. 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.
- The decrease in net assets of \$21.9 million results primarily from the issuance of debt for school construction of \$77.3 million, offset by the fund balance increases noted above in the general and debt service funds and a \$7.9 million increase in 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 Supplemental Information (Budgetary Comparison Schedules)
- Combining Statements and Individual Fund Statements and Schedules

BASIC FINANCIAL STATEMENTS

Shelby County's basic financial statements are comprised of three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the 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.

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 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 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 and the retirement system. 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." For the Shelby County Retirement System (a fiduciary fund), the required supplementary information is a schedule of funding progress and disclosures related to the actuarial valuations.

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, 2005). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2005 and as of June 30, 2004. The 2004 amounts have been restated for items reported in Note IV (Q) of the Notes to Financial Statements.

Property taxes receivable is by far the largest portion of Shelby County's assets (60.3% at June 30, 2005 and 57.8% at June 30, 2004). The June 30, 2005 property taxes receivable includes \$642 million, offset by an equal deferred revenue amount in other liabilities, that became a property lien on January 1, 2005 but are levied for next fiscal year's operations. The similar amount at June 30, 2004 was \$564 million. Total assets increased \$79.7 million, attributable primarily to increases in property taxes receivable and capital assets.

Liabilities increased \$101.6 million during the year. This increase was due primarily to an increase of \$101.5 million in notes payable from short term borrowing and \$75 million in deferred revenues, offset by a decrease of \$49 million in long-term liabilities and of \$25 million in other liabilities.

Table 1
Condensed Statement of Net Assets
As of June 30, 2005 and 2004

	June 30, 2005	June 30, 2004	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 683,388,277	\$ 608,918,477	\$ 74,469,800
Current and other assets	182,230,392	193,207,184	(10,976,792)
Capital assets	230,194,262	209,775,976	20,418,286
Total assets	<u>1,095,812,931</u>	<u>1,011,901,637</u>	<u>83,911,294</u>
Long-term liabilities	1,615,507,305	1,664,400,266	(48,892,961)
Other liabilities	876,309,709	724,406,873	151,902,836
Total liabilities	<u>2,491,817,014</u>	<u>2,388,807,139</u>	<u>103,009,875</u>
Invested in capital, net of related debt	(165,081,297)	(187,605,328)	22,524,031
Restricted	46,561,030	25,939,996	20,621,034
Unrestricted	<u>(1,277,483,816)</u>	<u>(1,215,240,170)</u>	<u>(62,243,646)</u>
Total net assets	<u>(1,396,004,083)</u>	<u>(1,376,905,502)</u>	<u>(19,098,581)</u>
<u>Business-Type Activities</u>			
Current and other assets	8,845,780	12,101,589	(3,255,809)
Capital assets	28,975,090	29,910,693	(935,603)
Total assets	<u>37,820,870</u>	<u>42,012,282</u>	<u>(4,191,412)</u>
Long-term liabilities	5,066,405	5,402,422	(336,017)
Other liabilities	1,126,468	2,210,313	(1,083,845)
Total liabilities	<u>6,192,873</u>	<u>7,612,735</u>	<u>(1,419,862)</u>
Invested in capital, net of related debt	28,180,902	29,047,386	(866,484)
Unrestricted	<u>3,447,095</u>	<u>5,352,161</u>	<u>(1,905,066)</u>
Total net assets	<u>31,627,997</u>	<u>34,399,547</u>	<u>(2,771,550)</u>
<u>Total Primary Government</u>			
Property taxes receivable	683,388,277	608,918,477	74,469,800
Current and other assets	191,076,172	205,308,973	(14,232,601)
Capital assets	259,169,352	239,686,669	19,482,683
Total assets	<u>1,133,633,801</u>	<u>1,053,913,919</u>	<u>79,719,882</u>
Long-term liabilities	1,620,573,710	1,669,802,688	(49,228,978)
Other liabilities	877,436,177	726,617,186	150,818,991
Total liabilities	<u>2,498,009,887</u>	<u>2,396,419,874</u>	<u>101,590,013</u>
Invested in capital, net of related debt	(136,900,395)	(158,557,942)	21,657,547
Restricted	46,561,030	25,939,996	20,621,034
Unrestricted	<u>(1,274,036,721)</u>	<u>(1,209,888,009)</u>	<u>(64,148,712)</u>
Total net assets	<u>\$ (1,364,376,086)</u>	<u>\$ (1,342,505,955)</u>	<u>\$ (21,870,131)</u>

“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 negative net asset amount is caused by two significant factors. The first factor and largest dollar 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:

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Shelby County and City of Memphis schools	\$ 996,948,343	\$ 951,593,850
Shelby County Health Care Corporation (component unit)	109,735,538	115,761,611
Convention Center (joint venture)	73,511,090	75,355,398
Other	77,219,418	80,136,996
Total	<u>\$ 1,267,414,389</u>	<u>\$ 1,222,847,855</u>

The second factor that contributes to the negative net asset amount relates to "infrastructure" capital assets acquired prior to July 1, 2001. These are mostly roads and bridges. GASB Statement No. 34 referenced above requires that these infrastructure capital assets be reported not later than fiscal year 2006. The County will report these capital assets next fiscal year. Some of the long-term debt liability reported was used to acquire or construct these infrastructure capital assets. Since the debt is being reported but the assets have not yet been reported, a negative net asset amount results.

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 decreased by \$21.9 million, which is primarily due to the increase in debt for schools' capital assets as discussed above. Excluding the increase in debt for which the related capital assets are not recorded by Shelby County (schedule above) of \$44.6 million, the County's total net assets increased by \$22.7 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, 2005, with comparative amounts for the fiscal year ending June 30, 2004.

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. Program revenues decreased 2.1% during the year. General revenues are those revenues not generated through the activities of the County; property taxes produce the largest amount of general revenues. General revenues increased 1.5% during the year. Overall revenues increased 0.7% during the year.

Table 2
Shelby County Change in Net assets
Fiscal Years Ending June 30, 2005 and 2004

	FY 2005	FY 2004	Change
Governmental activities:			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 87,079,570	\$ 81,410,002	\$ 5,669,568
Operating grants and contributions	119,186,843	121,711,056	(2,524,213)
Capital grants and contributions	277,257	7,818,000	(7,540,743)
Total program revenues	<u>206,543,670</u>	<u>210,939,058</u>	<u>(4,395,388)</u>
General revenues:			
Property taxes	587,164,493	582,711,510	4,452,983
Other taxes	85,517,893	82,726,123	2,791,770
Other	5,660,042	2,782,079	2,877,963
Total general revenues	<u>678,342,428</u>	<u>668,219,712</u>	<u>10,122,716</u>
Total revenues-governmental activities	<u>884,886,098</u>	<u>879,158,770</u>	<u>5,727,328</u>
<u>Expenses:</u>			
General government	46,228,263	62,965,112	(16,736,849)
Hospital	25,566,667	28,213,585	(2,646,918)
Planning & development	6,084,407	7,363,302	(1,278,895)
Public works	34,934,896	23,258,832	11,676,064
Corrections	371,598	825,555	(453,957)
Health services	50,576,288	50,318,012	258,276
Community services	41,010,999	39,778,703	1,232,296
Law enforcement	128,391,275	126,651,679	1,739,596
Judicial	52,348,970	50,271,461	2,077,509
Other elected officials	31,109,337	29,561,524	1,547,813
Education	404,270,674	428,873,650	(24,602,976)
Interest on debt	75,944,617	65,885,498	10,059,119
Total expenses-governmental activities	<u>896,837,991</u>	<u>913,966,913</u>	<u>(17,128,922)</u>
Increase (decrease) in net assets before transfers	(11,951,893)	(34,808,143)	22,856,250
<u>Transfers</u>	<u>(7,146,688)</u>	<u>(11,861,324)</u>	<u>4,714,636</u>
Increase (decrease) in net assets	(19,098,581)	(46,669,467)	27,570,886
Net assets – beginning of year	<u>(1,376,905,502)</u>	<u>(1,330,236,035)</u>	<u>(46,669,467)</u>
Net assets - end of year	<u>(1,396,004,083)</u>	<u>(1,376,905,502)</u>	<u>(19,098,581)</u>

Business-type activities:	<u>FY 2005</u>	<u>FY 2004</u>	<u>Change</u>
<u>Revenues:</u>			
Operating revenues:			
Charges for services	56,282,351	63,770,875	(7,488,524)
Operating grants and contributions	56,960	60,960	(4,000)
Total operating revenues	<u>56,339,311</u>	<u>63,831,835</u>	<u>(7,492,524)</u>
Non-operating revenues	283,040	486,261	(203,221)
Total revenues	<u>56,622,351</u>	<u>64,318,096</u>	<u>(7,695,745)</u>
<u>Expenses:</u>			
Codes enforcement	12,753,672	8,081,482	4,672,190
Nursing homes	-0-	15,783,099	(15,783,099)
Fire services	11,218,053	11,408,991	(190,938)
Corrections	42,568,864	44,288,051	(1,719,187)
Total expenses	<u>66,540,589</u>	<u>79,561,623</u>	<u>(13,021,034)</u>
Increase (decrease) in net assets before transfers	(9,918,238)	(15,243,527)	5,325,289
<u>Transfer</u>	<u>7,146,688</u>	<u>11,861,324</u>	<u>(4,714,636)</u>
Increase (decrease) in net assets	(2,771,550)	(3,382,203)	610,653
Net assets - beginning of year	34,399,547	37,781,750	(3,382,203)
Net assets - end of year	<u>31,627,997</u>	<u>34,399,547</u>	<u>(2,771,550)</u>
Total primary government:			
Increase (decrease) in net assets	(21,870,131)	(50,051,670)	28,181,539
Net assets - beginning of year	(1,342,505,955)	(1,292,454,285)	(50,051,670)
Net assets - end of year	<u>\$ (1,364,376,086)</u>	<u>\$ (1,342,505,955)</u>	<u>\$ (21,870,131)</u>

Total expenses for the year in governmental activities decreased \$17.1 million (1.9%). The decrease in general government (\$16.7 million) and the increase in public works (\$11.7 million) includes the shift of \$12.5 million from general government to public works. Education expenses decreased \$24.6 million because the prior year included \$29 million of school debt to build a new high school.

In business-type activities, total revenues decreased by \$7.7 million. However, FY 2004 included \$9.7 million of revenue from the Oakville Health Care Center; Oakville was sold as of June 30, 2004 so there was no revenue from this activity in FY 2005. Approximately 75% of the inmates at the Corrections Center are the responsibility of the State of Tennessee. The State pays the Corrections Center their share of actual cost per inmate day. The general fund provides an operating transfer for the costs not recovered from the state. The change in net assets in this fund generally represents non-cash changes in long term assets and liabilities.

CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during fiscal year 2005 was a decrease in net assets of \$21.9 million.

The County's governmental activities operated at a deficit of approximately \$19.1 million. This was mostly debt issued for component units, the City of Memphis Board of Education, and others where the County retains liability for the debt but does not hold the related capital assets. This situation is discussed more at length above.

The business-type activities had a net decrease of \$2.8 million. This resulted from a planned reduction in net assets of Consolidated Codes Enforcement, offset somewhat by operating profits in the Fire Services Fund.

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 deficit fund balance of \$48,337,208. The components of the balances are:

	June 30, 2005	June 30, 2004
General Fund-reserved/designated	\$ 4,158,337	\$ 5,260,223
General Fund-unreserved	37,539,543	30,181,239
Debt Service Fund	29,241,588	9,457,475
Special revenue funds	17,374,768	16,482,521
Total, except Capital Projects Fund	88,314,236	61,381,458
Capital Projects Fund	(132,651,444)	(24,919,442)
Total all governmental funds	<u>\$ (48,337,208)</u>	<u>\$ 36,462,016</u>

There was a \$26.9 million increase in fund balance excluding capital projects. The decrease in the capital projects fund results from the use of short-term borrowing for capital projects as discussed below.

The general fund operated with net revenue of \$6.1 million, resulting from revenue exceeding budget by \$3 million and expenditures being \$3 million under budget. The County had planned to increase unreserved fund balance by at least \$1 million to provide more resources to absorb potential negative financial events. 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 12.5 percent of total general fund expenditures, while total fund balance represents 13.8 percent of that same amount. General fund revenues were \$24 million (7.2%) below the prior year, which resulted primarily from shifting local property taxes from the general fund to the debt service fund. Expenditures were \$15.4 million less (4.9%) than the prior year and net transfers were \$4.4 million less. Before the beginning of FY 2004 management committed to increasing unreserved fund balance of the general fund by \$10 million over the next two years; the actual increase for those two years was \$19.3 million.

The debt service fund has a total fund balance of \$29,241,588 to be used for the payment of debt service. The net increase in fund balance during the current year was \$19,784,113. This increase resulted from revenue exceeding budget by \$4.5 million and a refinancing debt issue providing \$10.7 million as an other financing source and a \$4.7 million reduction in debt service expenditures.

The increase in the fund deficit of the capital projects fund was the result of issuing short-term debt for capital improvement projects. At the conclusion of each short-term borrowing program (generally two years), the short-term debt is refinanced with long-term general obligation debt. Short-term debt is recorded as a liability of the capital projects fund and, to the extent such borrowings have been spent, a fund deficit is created. The deficit is cleared when long-term debt is issued. Short-term debt outstanding at June 30, 2005 was \$141.0 million compared to \$39.5 million at June 30, 2004.

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.

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. The Corrections Center receives reimbursement from the State of Tennessee for housing State prisoners, which are about 75% 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 \$3,447,095, a decrease of 48.2%.

Total net assets of the enterprise funds decreased \$2,771,550, or about 8.1%, during the year. This decrease was caused 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, 2005 these funds combined had net assets of \$7,861,063, an improvement of \$7,892,499 over the deficit of \$31,436 from the prior year. The employer insurance fund had a deficit at June 30, 2004 of \$3,894,774; this was reduced to a deficit of \$3,114,027 at June 30, 2005. This deficit is the result of claims that will be paid over a period of years being recorded when the claim occurs. The County's policy is to provide funding for long term claims on a claims paid basis. All the other funds have positive net assets.

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 are equal to the currently calculated actuarial liability, meaning the system is properly 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:

- Overall the expenditure budget decreased during the year by \$546,453, or about two-tenths of one percent. Actual expenditures were \$3 million below the amended budget, or 1.0%.
- The budget for general government was increased during the year by \$3.4 million, or 9.5%.
- The budget for health services was decreased during the year by \$2.2 million, or 7.2%.
- The budget for law enforcement was decreased during the year by \$2.0 million, or 1.6%. Actual expenditures were also \$1.2 million below the amended budget, or about 1.0%.
- The budget for judicial was decreased during the year by \$1.6 million, or about 4.2%.
- The budget for other elected officials was increased during the year by \$2.8 million, or about 10.9%.
- The revenue budget was decreased during the year by \$213,435, or less than one-tenth of one percent, from the original budget. Actual revenues were \$3.1 million, or about 1.0%, above the amended budget.
- Budgeted net transfers out were increased by \$1.4 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, 2005 amounts to \$259,169,352 (net of accumulated depreciation). This investment in capital assets includes land, buildings and system improvements, machinery and equipment, park facilities and roads. Infrastructure, primarily roads, acquired prior to July 1, 2001 are not included. GASB Statement No. 34 requires the inclusion of infrastructure acquired beginning July 1, 2001 with retroactive reporting of infrastructure required not later than the County's fiscal year ending June 30, 2006.

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 \$7.6 million.
- Renovation work continued at the Criminal Justice Complex, with projects including centralization of the floor pod control, jail door retrofit, and jail control center.
- Funding for the radio frequency and equipment upgrades project totaled \$10.8 million.

Construction in progress as of the end of the current fiscal year was \$43,087,654.

Long-term Debt. At June 30, 2005 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,569,111,426 which represented approximately 10.35 percent of assessed value. In addition, the County has short-term notes payable of \$141 million, an increase of \$101.5 million. These notes payable will be converted to long term debt during the next two years. The County's bonds and notes payable increased by approximately \$51.1 million (3.1%) 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. In fiscal year 2004 a \$115 million notes payable program was authorized that had notes payable of \$111 million outstanding at June 30, 2005. In fiscal year 2005 a \$275 million notes program was authorized that had notes payable of \$30 million outstanding at June 30, 2005.

In 1999 the County signed a funding agreement with the Shelby County and the City of Memphis School boards of education to provide \$655,250,000 of capital funding over eight years. Under this agreement, the County is committed to provide approximately \$77 million of capital funding to the schools in the next fiscal year, the final year of the agreement. A new agreement was signed in 2005 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 describes 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 June 2005 unemployment rate for Shelby County was 7.7 percent, compared to the state's rate of 6.3 percent.
- Inflationary trends in the region compare favorably to national indices.

For 2006 the property tax rate was maintained at the same amount as 2005. All properties were reappraised as of January 1, 2005, which are the basis for property taxes for fiscal 2006. As a result of the combination of growth and the increase in appraised values, current property taxes are budgeted to increase 9% or \$51 million in 2006 over the 2005 budget. Education was provided an increase of \$24 million (8.5%) and debt service was provided an increase of \$24 million to meet debt service growth as discussed below. The general fund was only allocated an increase of \$3 million or 1.6%.

For fiscal 2006 general fund revenue growth is budgeted to be 2.9% over the 2005 budget. Actual revenue for 2005 exceeded the amount budgeted so that only 1.7% growth in actual revenue will be necessary to reach the budget. General fund expenditures were also budgeted to

increase by 2.9% compared to 2005. 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 increasing the incorporated area, county government is shifting responsibilities to the cities and focusing on our primary mission of education, criminal justice and health. 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. Also, controls have been put in place to minimize hiring to shrink county government through attrition. These measures have allowed the 2006 general fund budgeted expenditures to be less than actual expenditures in 2003.

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 \$6 million in 2006. Property reappraisal as of January 1, 2005 allowed us to transfer 10 cents of the property tax rate to the debt service fund to replace non-recurring revenue and to provide for debt service projected increases through fiscal 2009.

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 \$116 million in 2005. The five-year capital improvement plan was updated with reductions in new debt requirements except for the additional \$100 million commitment for schools noted above which is expected to be split equally between 2006 and 2007. Starting in 2008, the capital improvement plan provides for expenditures of less than \$80 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.