

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, 2004. 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.

In the United States financial reporting standards for governmental entities are established by the Governmental Accounting Standards Board (GASB). This is the third 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 \$30,181,239, or 9.5 percent of total general fund expenditures. This was an increase of \$11,959,547, or a 65.6% increase.
- Fund balance for the debt service fund decreased \$1.2 million to \$9,457,475, which is 8.1% of total expenditures of the debt service fund. The decrease was planned and the balance is well above our target level of \$4 million.
- Total liabilities of Shelby County exceed total assets as of June 30, 2004 by \$1,342,505,955. 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 \$50,051,670 results primarily from the issuance of debt for school construction of \$109 million, less \$20 million not yet expended and reflected as due to component unit. This is offset by the \$10 million fund balance increase in the general fund and a \$7 million increase in net assets of 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 include codes enforcement, a nursing home, 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, 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 narrower 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 eleven 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 six 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 its Oakville Health Care Center, 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 long-term debt and capital assets, whereas the fund balance sheet includes neither. The government-wide statement of activities includes long-term debt incurred during the year and depreciation expense but not amounts expended for capital assets during the year; the fund statement of revenues, expenditures, and changes in fund balances includes amounts expended during the year to pay long-term debt but not long-term debt incurred and 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 SUPPLEMENTAL INFORMATION

This section contains other information that financial reporting standards specify should be included under this caption. The only such information Shelby County is required to present are budgetary comparison schedules for the general fund and other "major" special revenue funds (the education fund and the grants fund). A budgetary comparison schedule for each of these funds has been provided 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 very condensed version of the Statement of Net Assets (see the government-wide financial statements for the full version as of June 30, 2004). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2004 and as of June 30, 2003.

Property taxes receivable is by far the largest portion of Shelby County's assets (57.8% at June 30, 2004 and 60.6% at June 30, 2003). The June 30, 2004 property taxes receivable includes \$564 million, offset by an equal deferred revenue amount in other liabilities, that became a property lien on January 1, 2004 but are levied for next fiscal year's operations. The similar amount at June 30, 2003 was \$556 million. Total assets increased \$63 million, attributable to increases in cash and cash equivalents, property taxes receivable and capital assets.

Liabilities increased \$113 million during the year. This increase was due primarily to an increase of \$265 million in long-term liabilities and a reduction of \$181 million in notes payable from short term borrowing.

Table 1
Condensed Statement of Net Assets
As of June 30, 2004 and 2003

	June 30, 2004	June 30, 2003	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 608,918,477	\$ 599,817,632	\$ 9,100,845
Current and other assets	191,901,370	151,525,256	40,376,114
Capital assets	209,775,976	191,225,684	18,550,292
Total assets	<u>1,010,595,823</u>	<u>942,568,572</u>	<u>68,027,251</u>
Long-term liabilities	1,664,400,266	1,398,976,333	265,423,933
Other liabilities	724,406,873	875,134,088	(150,727,215)
Total liabilities	<u>2,388,807,139</u>	<u>2,274,110,421</u>	<u>114,696,718</u>
Invested in capital, net of related debt	(187,605,328)		(187,605,328)
Restricted	25,939,996	33,428,619	(7,488,623)
Unrestricted	(1,216,545,984)	(1,364,970,468)	148,424,484
Total net assets	<u>(1,378,211,316)</u>	<u>(1,331,541,849)</u>	<u>(46,669,467)</u>
<u>Business-Type Activities</u>			
Current and other assets	12,101,589	13,032,472	(930,883)
Capital assets	29,910,693	33,883,889	(3,973,196)
Total assets	<u>42,012,282</u>	<u>46,916,361</u>	<u>(4,904,079)</u>
Long-term liabilities	5,402,422	5,921,580	(519,158)
Other liabilities	904,499	1,907,217	(1,002,718)
Total liabilities	<u>6,306,921</u>	<u>7,828,797</u>	<u>(1,521,876)</u>
Invested in capital, net of related debt	29,047,386	33,372,974	(4,325,588)
Unrestricted	6,657,975	5,714,590	943,385
Total net assets	<u>35,705,361</u>	<u>39,087,564</u>	<u>(3,382,203)</u>
<u>Total Primary Government</u>			
Property taxes receivable	608,918,477	599,817,632	9,100,845
Current and other assets	204,002,959	164,557,728	39,445,231
Capital assets	239,686,669	225,109,573	14,577,096
Total assets	<u>1,052,608,105</u>	<u>989,484,933</u>	<u>63,123,172</u>
Long-term liabilities	1,669,802,688	1,404,897,913	264,904,775
Other liabilities	725,311,372	877,041,305	(151,729,933)
Total liabilities	<u>2,395,114,060</u>	<u>2,281,939,218</u>	<u>113,174,842</u>
Invested in capital, net of related debt	(158,557,942)	33,372,974	(191,930,916)
Restricted	25,939,996	33,428,619	(7,488,623)
Unrestricted	(1,209,888,009)	(1,359,255,878)	149,367,869
Total net assets	<u>\$ (1,342,505,955)</u>	<u>\$ (1,292,454,285)</u>	<u>\$ (50,051,670)</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 liabilities are reported by the County for which related capital assets are not recorded by Shelby County:

	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Shelby County and City of Memphis schools	\$ 913,093,850	\$ 689,737,629
Shelby County Health Care Corporation (component unit)	115,761,611	102,484,913
Convention Center (joint venture)	75,355,398	77,095,552
Other	80,136,996	77,505,978
Total	<u>\$ 1,184,347,855</u>	<u>\$ 946,824,072</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 include these capital assets as soon as the historical records can be researched to determine the amounts for these previously unreported assets. 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.

It should be noted that 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, it should be noted that 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 \$50 million, which is primarily due to issuing debt for schools' capital assets as discussed above. Excluding the effect of school debt, net assets increased by \$39 million due to changes within the funds that 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, 2004, with comparative amounts for the fiscal year ending June 30, 2003.

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 increased (5.9%) 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 5.5% during the year. Overall revenues increased about 5.6% during the year.

Table 2
Shelby County Change in Net assets
Fiscal Years Ending June 30, 2004 and 2003

	FY 2004	FY 2003	Change
Governmental activities:			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 81,410,002	\$ 80,435,713	\$ 974,289
Operating grants and contributions	121,711,056	110,997,403	10,713,653
Capital grants and contributions	7,818,000	7,703,724	114,276
Total program revenues	<u>210,939,058</u>	<u>199,136,840</u>	<u>11,802,218</u>
General revenues:			
Property taxes	582,711,510	559,384,367	23,327,143
Other taxes	82,726,123	65,481,890	17,277,233
Other	2,782,079	8,549,134	(5,767,055)
Total general revenues	<u>668,219,712</u>	<u>633,415,391</u>	<u>34,804,321</u>
Total revenues-governmental activities	<u>879,158,770</u>	<u>832,552,231</u>	<u>46,606,539</u>
<u>Expenses:</u>			
General government	62,965,112	78,453,282	(15,488,170)
Hospital	28,213,585	33,452,571	(5,238,986)
Planning & Development	7,363,302	7,310,134	53,168
Public Works	23,258,832	16,873,274	6,385,558
Corrections	825,555	937,223	(111,668)
Health Services	50,318,012	51,345,969	(1,027,957)
Community Services	39,778,703	39,535,231	243,472
Law Enforcement	126,651,679	141,356,464	(14,704,785)
Judicial	50,271,461	51,424,360	(1,152,899)
Other Elected Officials	29,561,524	29,382,392	179,132
Education	428,873,650	398,704,841	30,168,809
Interest on debt	65,885,498	71,847,109	(5,961,611)
Total expenses-governmental activities	<u>913,966,913</u>	<u>920,622,850</u>	<u>(6,655,937)</u>
Increase (decrease) in net assets before transfers	(34,808,143)	(88,070,619)	53,262,476
Transfers	<u>(11,861,324)</u>	<u>(6,154,513)</u>	<u>(5,706,811)</u>
Increase (decrease) in net assets	(46,669,467)	(94,225,132)	47,555,665
Net assets - beginning of year	(1,331,541,849)	(1,237,316,717)	(94,225,132)
Net assets - end of year	<u>(1,378,211,316)</u>	<u>(1,331,541,849)</u>	<u>(49,669,467)</u>

Business-type activities:Revenues:

Operating revenues:

Charges for services	63,770,875	69,891,427	(6,120,552)
Operating grants and contributions	60,960	47,175	13,785
Total operating revenues	63,831,835	69,938,602	(6,106,767)
Non-operating revenues	486,261	388,156	98,105
Total revenues	64,318,096	70,326,758	(6,008,662)

Expenses:

Codes Enforcement	8,081,482	7,571,869	509,613
Nursing Homes	15,783,099	15,372,131	410,968
Fire Services	11,408,991	10,727,950	681,041
Corrections	44,288,051	43,873,787	414,264
Total expenses	79,561,623	77,545,737	2,015,886

Increase (decrease) in net assets

before transfers

(15,243,527)	(7,218,979)	(8,024,548)
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Transfer

11,861,324	6,154,513	5,706,811
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Increase (decrease) in net assets

(3,382,203)	(1,064,466)	(2,317,737)
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Net assets - beginning of year

39,087,564	40,152,030	(1,064,466)
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Net assets - end of year

35,705,361	39,087,564	(3,382,203)
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Total primary government:

Increase (decrease) in net assets	(50,051,670)	(95,289,598)	45,237,928
Net assets - beginning of year	(1,292,454,285)	(1,197,164,687)	(95,289,598)
Net assets - end of year	\$ (1,342,505,955)	\$ (1,292,454,285)	\$ (50,051,670)

Total expenses for the year in governmental activities decreased \$6.7 million. The largest decreases were in general government (\$15.5 million or 19.7%) and in law enforcement (\$14.7 million or 10.4%). Education expenses increased \$30.2 million (7.6%).

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. Oakville Health Care Center operates at a deficit, which is funded by an operating transfer from the General Fund. Losses in these funds generally represent 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 2004 was a decrease in net assets of \$50,051,670.

The County's governmental activities operated at a deficit of approximately \$46.7 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 \$3.4 million. These occurred because of operating losses at the Corrections Center and Oakville Health Care Center, offset somewhat by operating profits in the Fire Services Fund and Consolidated Codes Enforcement. The loss at the Oakville Health Care Center was higher than normal due to certain costs in connection with the sale of the facility and the loss on the sale based on book values; the facility was sold on June 30, 2004.

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 \$36,462,016. The components of the balances are:

	June 30, 2004	June 30, 2003
Debt Service	\$ 9,457,475	\$ 10,702,422
Special Revenue	16,482,521	16,555,753
General Fund-reserved/designated	5,260,223	6,934,189
General Fund-Unreserved	30,181,239	18,225,510
Total, except capital projects fund	61,381,458	52,417,874
Capital projects fund	(24,919,442)	(211,212,848)
Total all governmental funds	\$ 36,462,016	\$ (158,794,974)

There was a \$195.3 million improvement over the deficit of \$158.8 million from the prior year. This improvement was primarily the result of issuing long-term debt to repay short-term debt for capital improvement projects. Shelby County uses short-term debt to finance capital 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, as occurred in FY 2004. Short-term debt outstanding at June 30, 2004 was \$39.5 million compared to \$220.3 million at June 30, 2003.

The general fund operated with net revenue of \$10.3 million, resulting in a general fund unreserved and undesignated balance of \$30,181,239. This was a planned increase in the unreserved fund balance 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 already been committed 1) to pay debt service, 2) for road repair and maintenance, 3) to liquidate contracts and purchase orders of the prior period, or 4) for a variety of other restricted purposes.

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 9.5 percent of total general fund expenditures, while total fund balance represents 11.2 percent of that same amount. General fund revenues were \$32 million (10.5%) above the prior year, of which \$25 million resulted from increasing the property tax rate. Expenditures were \$9.3 million less (2.9%) than the prior year but net transfers were \$9.9 million more. Before the beginning of FY 2004 management committed to increasing fund balance of the general fund by \$10 million over the next two years. This was accomplished in one year.

The reduction in the fund deficit of the capital projects fund results from notes payable amounts converted to long-term general obligation bonds exceeding the amount of notes issued during the year for capital projects.

The debt service fund has a total fund balance of \$9,457,475, which is restricted for the payment of debt service. The net decrease in fund balance during the current year was \$1,244,947. The decrease resulted from the planned usage of some fund balance to move towards our target debt service fund balance of \$4 million.

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 four 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. Two other activities have consistently been unable to support themselves. The Oakville Health Care Center has a cost structure that is above industry averages and the general fund provides a subsidy excluding depreciation. 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 \$6,657,975, an improvement of 16.5%.

Total net assets of the Enterprise Funds decreased \$3,382,203 during the year. Of this decrease, \$2,656,743 occurred at the Oakville Health Care Center. The Oakville facility and operations were sold on June 30, 2004, which is why there are no remaining Statement of Net Asset balances for Oakville. Over \$1 million of the Oakville deficit was the result of the loss on the sale of assets (based on book value of the assets) and some related costs of discontinuing the operation.

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, 2004, these funds combined had deficit net assets of \$31,436, an improvement of \$7,251,261 over the deficit of \$7,282,697 from the prior year. The group hospital insurance fund had a deficit at June 30, 2003 of \$2,949,719; however premiums exceeded expenses by \$4,424,157 during the current year. The employer insurance fund had a deficit at June 30, 2003 of \$6,369,650; this was reduced to a deficit of \$3,894,774 at June 30, 2004. 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 increased during the year by \$799,102, or about one-fourth of one percent. Actual expenditures were \$8 million below the amended budget, or 2.5%.
- The budget for law enforcement was increased during the year by \$1.2 million, or 1%.
- The budget for public works was increased during the year by \$1.2 million, or 1.7%.
- The budget for general government was decreased during the year by \$3.3 million, or 5.6%.
- The revenue budget was increased during the year by \$4.8 million, or 1.5% over the original budget. The budget for local taxes was increased \$2.2 million as the result of a greater percentage of property tax assessments being collected. The budget for elected officials fines & fees was increased \$1.9 million. Actual revenues were 1.0% above the amended budget.
- Budgeted net transfers out were increased by \$4.0 million.

There were no significant adjustments to the Education Fund budget. The Grants Fund revenue and expenditures/transfers budgets were increased by approximately \$12.8 million, primarily for grants received after the budget was prepared.

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, 2004 amounts to \$239,686,669, (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, although early implementation is permitted. The County is in the process of accumulating this historical data in order to implement retroactive reporting of infrastructure.

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 \$8.3 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.
- New high-speed printers and software upgrades for the jail management system cost approximately \$1.3 million.
- Funding for the radio frequency and equipment upgrades project was increased by \$3 million, for a project total of \$11.3 million.

Construction in progress as of the end of the current fiscal year was \$42,980,947.

Additional information on Shelby County Government's capital assets can be found in Notes to Financial Statements of this report.

Long-term Debt. At June 30, 2004 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,619,508,673 which represented approximately 10.4 percent of assessed value. In addition, the County has short-term notes payable of \$39,500,000, which will be converted to long term debt during the next two years. Debt, generally, may be issued without regard to any limit on indebtedness. The ad valorem tax levy is also without legal limit.

The County's bonds payable increased by approximately \$265.2 million (16.4 percent) during the current fiscal year. The key factor in this increase was the conversion of \$318.9 million of notes payable to bonds payable to take advantage of the historically low long term interest rates.

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 has notes payable of \$39.5 million outstanding at June 30, 2004.

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 each of the next two years.

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 2004 unemployment rate for Shelby County was 5.9 percent, compared to the state's rate of 4.5 percent and the national average unemployment rate of 5.4 percent.
- Inflationary trends in the region compare favorably to national indices.

The County Mayor and Commission have determined that we need to make every effort to not increasing the property tax rate. 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.

For fiscal 2005, budgeted general fund expenditures were reduced by \$19 million compared to 2004. A portion of this reduction results from transferring funding for areas such as libraries and parks to the municipalities. In addition, a consulting firm was engaged to perform an efficiency study and assist us in preparing a five year strategic plan. Substantial efficiencies have been identified and implemented. Also, controls have been put in place to minimize hiring to shrink county government through attrition.

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 \$20 million in 2005. The reduction in the general fund budget allowed us to transfer 12 cents of the property tax rate (\$16.7 million) to the debt service fund.

Historically when the County issued bonds for the capital needs of schools, the proceeds were distributed to the two school systems (Shelby County and City of Memphis) based on each system's student average daily attendance. Due to suburban growth, the County school system has experienced a much greater immediate need for capital funds for the past decade or more. While the share of funds distributed to the City school system has permitted the City system to undertake renovation or replacement of deteriorating facilities, the required sharing has been a major factor in the escalating County debt. In 2004, the County Commission approved the financing of a new County school to be repaid from a separate part of the property tax rate that is assessed only to property outside the City of Memphis. This required issuing debt only for the one new school with no sharing of funds with the City school system.

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 were reduced from \$154 million in 2002 to \$135 million in 2004. The five-year capital improvement plan was updated with reductions in new debt requirements. In 2004, bonds and notes payable for capital outlay increased \$138 million. In 2005, we expect to issue approximately \$100 million of debt for capital outlay.

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.