

### 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, 2010. We encourage readers to consider the information presented here in conjunction with information in the transmittal letter found at the front of this report and the basic financial statements, which follow in this section.

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

### Financial Highlights

- At the end of the current fiscal year, unassigned fund balance for the general fund was \$75.7 million, or 21.1% of total general fund revenue. This compares to the unrestricted fund balance at the end of the previous year of \$74.4 million, or 20.8% of general fund revenue.
- Fund balance for the debt service fund increased \$27.9 million to \$102.5 million, which is 52.1% of total revenue of the debt service fund. The balance is consistent with our debt plan to provide for future debt service requirements.
- The capital projects fund balance increased \$185.7 million to a balance of \$101.3 million. This was the result of issuing \$120.0 million of bonds to retire short-term borrowing used to finance capital projects and the proceeds of a \$55.1 mill loan for school capital projects through the State of Tennessee under the Qualified School Construction Bond program.
- Total liabilities of Shelby County exceed total assets as of June 30, 2010 by \$802.9 million. The largest contributing factor causing this deficit is the fact that the County issues debt on behalf of entities not a part of the County's primary financial reporting unit and the related assets are not recorded by the County. These entities include the school systems of Shelby County and the City of Memphis, joint ventures with the City of Memphis, and others. Outstanding debt for these entities as of June 30, 2010 was \$1,355,930,329.
- Total government-wide net assets increased \$120.6 million as a result of activity for the fiscal year, with an increase of \$123.4 million from governmental activities and a decrease of \$2.8 million from business-type activities.

More details on these highlights and other information are in the remainder of this discussion and analysis.

### Overview of the Financial Report

The Comprehensive Annual Financial Report includes three major sections – Introductory Section, Financial Section, and Statistical Section. The Introductory Section includes a transmittal letter and general information about the County. The Statistical Section includes financial and non-financial data, some from sources other than financial records and often covering up to ten years. The Financial Section is the major part of the financial report. The Independent Auditor's Report applies only to the Financial Section. This discussion and analysis applies only to the Financial Section.

The Financial Section includes the following statements and schedules:

- Basic Financial Statements
  - Government-wide financial statements
  - Fund financial statements
  - Notes to financial statements
- Required Supplementary Information
- Combining Statements and Individual Fund Statements and Schedules

#### BASIC FINANCIAL STATEMENTS

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

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

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

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

services, community services, law enforcement, judicial, other elected officials, education and interest on debt. The business-type activities of Shelby County consist of codes enforcement, fire services and corrections center.

The government-wide financial statements include not only Shelby County itself - known as the *primary government* - but also four legally separate entities for which Shelby County is financially accountable. These entities are the Shelby County Board of Education, Shelby County Health Care Corporation (The Med), Agricenter International, and the Emergency Communications District (9-1-1). Financial information for these *component units* is reported separately from the financial information presented for the primary government itself. This discussion and analysis is devoted to Shelby County government rather than the component units.

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

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

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

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

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

used to accumulate and allocate costs internally among Shelby County's various functions. Shelby County uses internal service funds to account for its central services, group health, tort liability and employer insurance funds. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements. Enterprise funds and internal service funds are each combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the enterprise funds and internal service funds are provided in the form of *combining statements* elsewhere in this report.

*Fiduciary funds.* Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial 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, but also included are the Shelby County OPEB Trust and agency funds.

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

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

**Notes to 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. Supplementary information is presented for the Shelby County Retirement System and the Shelby County OPEB Trust. Shelby County is also required to present information on budgetary compliance. Budgetary comparison schedules are presented for the general fund and other "major" special revenue funds (the education fund and the grants fund) to demonstrate compliance with their budget. Other budgetary comparison schedules not fitting the criteria defined for this section are presented under "Combining Statements and Individual Fund Statements and Schedules."

**COMBINING STATEMENTS AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES**

Combining fund statements for the non-major special revenue funds, non-major enterprise funds and internal service funds are included in this section of the report. Supplemental schedules include general fund and grants fund budgetary comparisons by department, detail of constitutional officers' activities and schedules of debt by debt issue.

**Government-wide Financial Analysis  
(Reporting the County as a Whole)**

**FINANCIAL POSITION**

Table 1 shows a condensed version of the Statement of Net Assets (see the government-wide financial statements for the full version as of June 30, 2010). This statement shows the financial position of the County as a whole at specific points in time – in this case as of June 30, 2010 and as of June 30, 2009.

Property taxes receivable is by far the largest portion of Shelby County's assets (44.0% at June 30, 2010 and 44.6% at June 30, 2009). The June 30, 2010 property taxes receivable includes \$753.4 million, offset by an equal deferred revenue amount in other liabilities, which became a property lien on January 1, 2010 but are levied for next fiscal year's operations. The similar amount at June 30, 2009 was \$725.9 million. Total assets increased by \$103.8 million. This included increases in taxes receivable of \$33.9 million, increases in cash and cash equivalents and investments combined of \$72.0 million and smaller net decreases in other assets of \$2.1 million.

Liabilities decreased by \$16.7 million during the year. This decrease was due to an increase of \$85.9 million in long-term liabilities and decreases of \$102.6 million in other liabilities. Most of the change between long-term and other liabilities was due to the conversion of \$120.0 million of short-term notes payable to long-term debt during the year.

Table 1  
Condensed Statement of Net Assets  
As of June 30, 2010 and June 30, 2009

	June 30, 2010	June 30, 2009	Change
<u>Governmental Activities</u>			
Property taxes receivable	\$ 816,217,944	\$ 782,287,685	\$ 33,930,259
Current and other assets	449,189,750	372,455,391	76,734,359
Capital assets	543,765,068	550,093,389	(6,328,321)
Total assets	<u>1,809,172,762</u>	<u>1,704,836,465</u>	<u>104,336,297</u>
Long-term liabilities	1,777,143,478	1,693,145,626	83,997,852
Other liabilities	870,729,611	973,789,820	(103,060,209)
Total liabilities	<u>2,647,873,089</u>	<u>2,666,935,446</u>	<u>(19,062,357)</u>
Invested in capital, net of related debt	240,569,297	204,190,463	36,378,834
Restricted	207,993,719	87,310,795	120,682,924
Unrestricted	(1,287,263,343)	(1,253,600,239)	(33,663,104)
Total net assets	<u>(838,700,327)</u>	<u>(962,098,981)</u>	<u>123,398,654</u>
<u>Business-Type Activities</u>			
Current and other assets	22,065,107	21,478,449	586,658
Capital assets	25,154,882	26,230,845	(1,075,963)
Total assets	<u>47,219,989</u>	<u>47,709,294</u>	<u>(489,305)</u>
Long-term liabilities	8,651,466	6,810,644	1,840,822
Other liabilities	2,768,956	2,285,479	483,477
Total liabilities	<u>11,420,422</u>	<u>9,096,123</u>	<u>2,324,299</u>
Invested in capital, net of related debt	24,388,818	25,324,668	(935,850)
Unrestricted	11,410,749	13,288,503	(1,877,754)
Total net assets	<u>35,799,567</u>	<u>38,613,171</u>	<u>(2,813,604)</u>
<u>Total Primary Government</u>			
Property taxes receivable	816,217,944	782,287,685	33,930,259
Current and other assets	471,254,857	393,933,840	77,321,017
Capital assets	568,919,950	576,324,234	(7,404,284)
Total assets	<u>1,856,392,751</u>	<u>1,752,545,759</u>	<u>103,846,992</u>
Long-term liabilities	1,785,794,944	1,699,956,270	85,838,674
Other liabilities	873,498,567	976,075,299	(102,576,732)
Total liabilities	<u>2,659,293,511</u>	<u>2,676,031,569</u>	<u>(16,738,058)</u>
Invested in capital, net of related debt	264,958,115	229,515,131	35,442,984
Restricted	207,993,719	87,310,795	120,682,924
Unrestricted	(1,275,852,594)	(1,240,311,736)	(35,540,858)
Total net assets	<u>\$ (802,900,760)</u>	<u>\$ (923,485,810)</u>	<u>\$ 120,585,050</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 major factor causing this negative net asset amount relates to debt issued for capital assets (buildings, roads, etc.) where the capital asset values are *not* recorded in the County’s financial records but the debt *is* on the County’s records. Some of this debt has been issued to provide capital assets to component units

of the County, including the Shelby County Board of Education and the Shelby County Health Care Corporation (The Med). These component units report the capital assets but not the debt. Other debt is issued for entities not a part of the County reporting entity, including the Memphis City Schools Board of Education and the Convention Center. As a result of reporting the debt liabilities without reporting the assets acquired with the proceeds of the debt, a negative net asset amount is reported in the County’s statement of net assets.

The following long-term debt and notes payable are reported by the County for which related capital assets are not recorded by Shelby County:

	June 30, 2010	June 30, 2009
Shelby County and City of Memphis Schools	\$ 1,185,181,389	\$ 1,178,058,254
Shelby County Health Care Corp. (component unit)	74,932,946	82,316,669
Convention Center (joint venture)	58,273,905	62,181,609
Other	37,542,089	38,446,024
Total	\$ 1,355,930,329	\$ 1,361,002,556

Shelby County, the component units, and other entities (such as Memphis City Schools) use these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although Shelby County’s investment in its capital assets is reported net of related debt, the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

The County’s total net assets increased by \$120.6 million. The net increase in invested in capital assets, net of related debt constituted \$35.4 million of this increase; this was primarily due to the liquidation of long-term debt in an amount greater than the amount of new debt for capital projects. Restricted net assets increased by \$120.7 million, almost entirely due to debt service and capital project activities. The significant reasons for this increase can be generally understood from information in the sections below about “Changes in Net Assets” and the “Financial Analysis of the Government’s Funds.” Changes in net assets are discussed below.

**CHANGES IN NET ASSETS – REVENUES, EXPENSES AND TRANSFERS**

Table 2 summarizes the financial activity for the County as a whole for the fiscal year ending June 30, 2010, with comparative amounts for the fiscal year ending June 30, 2009.

For governmental activities, program revenues are those revenues generated by the department or program as a result of the activities engaged in by the department or program. General revenues are those revenues not generated through the activities of the County; property taxes produce the largest amount of general revenues. Program revenues increased by 1.8% or \$4.1 million, primarily due to a net increase in revenues from other governments. The shift between charges for services and operating grants and contributions resulted primarily from refinements to the classification of revenues of these two categories. General revenues increased \$44.5 million, with a 6.8% or \$49.1 million increase in property taxes. Other taxes had a net decrease of \$1.1

million, caused primarily by a decrease in sales taxes. Other general revenues are lower almost entirely because of \$3.4 million lower interest earnings.

Table 2  
Shelby County Change in Net Assets  
Fiscal Years Ended June 30, 2010 and 2009

	FY 2010	FY 2009	Change
<b>Governmental activities:</b>			
<u>Revenues:</u>			
Program revenues:			
Charges for services	\$ 108,459,891	\$ 82,189,738	\$ 26,270,153
Operating grants and contributions	114,344,216	136,145,188	(21,800,972)
Capital grants and contributions	710,000	1,126,464	(416,464)
Total program revenues	<u>223,514,107</u>	<u>219,461,390</u>	<u>4,052,717</u>
General revenues:			
Property taxes	773,832,412	724,765,511	49,066,901
Other taxes	93,635,983	94,721,982	(1,085,999)
Other	3,105,416	6,588,123	(3,482,707)
Total general revenues	<u>870,573,811</u>	<u>826,075,616</u>	<u>44,498,195</u>
Total revenues-governmental activities	<u>1,094,087,918</u>	<u>1,045,537,006</u>	<u>48,550,912</u>
<u>Expenses:</u>			
General government	63,105,682	53,354,405	9,751,277
Hospital	38,816,666	27,491,667	11,324,999
Planning & development	5,151,177	6,060,521	(909,344)
Public works	47,801,753	45,709,098	2,092,655
Corrections	1,481,007	1,318,182	162,825
Health services	59,823,299	61,837,782	(2,014,483)
Community services	72,340,940	59,988,698	12,352,242
Law enforcement	149,248,036	149,586,517	(338,481)
Judicial	66,108,459	77,792,534	(11,684,075)
Other elected officials	25,700,703	27,230,582	(1,529,879)
Education	363,281,302	420,351,443	(57,070,141)
Interest on debt	70,146,945	86,882,448	(16,735,503)
Total expenses-governmental activities	<u>963,005,969</u>	<u>1,017,603,877</u>	<u>(54,597,908)</u>
Increase (decrease) in net assets before transfers	131,081,949	27,933,129	103,148,820
<u>Transfers</u>	<u>(7,683,295)</u>	<u>(6,806,798)</u>	<u>(876,497)</u>
Increase (decrease) in net assets	123,398,654	21,126,331	102,272,323
Net assets - beginning of year	<u>(962,098,981)</u>	<u>(983,225,312)</u>	<u>21,126,331</u>
Net assets - end of year	<u>\$(838,700,327)</u>	<u>\$(962,098,981)</u>	<u>\$ 123,398,654</u>

Total expenses for the year in governmental activities decreased \$54.6 million (5.4%). The decrease of \$57.1 million for education was due to only nominal capital projects funding during the year, which are expenses to the County since the capital assets resulting from the funding are not County assets. The increase in general government was the result of paying out in FY2010 an



additional \$10.8 million of prior year tax revenue to an affiliated organization (the Memphis and Shelby County Sports Authority). The increase in Hospital was the result of a special appropriation of \$10 million to the Shelby County Health Care Corporation (dba The Med), a component unit. The increase in Community services was due primarily to an increase in grants funding, including several stimulus-related grants. The decrease in Judicial was primarily due to the loss of grant funds by the Juvenile Court to collect child support. A significant amount of the decrease in interest was due to the cost of liquidating a swap agreement in FY2009 and lower interest costs in FY2010 on the County's variable rate debt.

<b>Business-type activities:</b>	<u>FY 2010</u>	<u>FY 2009</u>	<u>Change</u>
<b>Revenues:</b>			
Operating revenues:			
Charges for services	\$ 72,752,829	\$ 76,330,759	\$ (3,577,930)
Operating grants and contributions	75,600	81,000	(5,400)
Total operating revenues	72,828,429	76,411,759	(3,583,330)
Non-operating revenues	48,728	207,994	(159,266)
Total revenues	72,877,157	76,619,753	(3,742,596)
<b>Expenses:</b>			
Operating expenses	83,374,056	79,802,179	3,571,877
Non-operating expenses and losses	-0-	6,796	(6,796)
Total expenses	83,374,056	79,808,975	3,565,081
Increase (decrease) in net assets before transfers	(10,496,899)	(3,189,222)	(7,307,677)
Transfers	7,683,295	6,806,798	876,497
Increase (decrease) in net assets	( 2,813,604)	3,617,576	(6,431,180)
Net assets - beginning of year	38,613,171	34,995,595	3,617,576
Net assets - end of year	35,799,567	38,613,171	(2,813,604)
<b>Total primary government:</b>			
Increase (decrease) in net assets	120,585,050	24,743,907	95,841,143
Net assets - beginning of year	(923,485,810)	(948,229,717)	24,743,907
Net assets - end of year	\$(802,900,760)	\$(923,485,810)	\$ 120,585,050

In business-type activities, operating revenues decreased by \$3.6 million. Of this decrease, \$2.3 million was in Corrections Center reimbursement for housing a reduced ratio of State inmates. There was a \$1.3 million decrease in Consolidated Codes as the result of lower inspection fees. Non-operating revenue decreased \$159,266 due to lower interest earnings, with some of the lower interest due to having used some cash to repay a loan to the general fund. Overall expenses increased \$3.6 million, or 4.5%.; Corrections increased \$3.1 million, Fire Services \$1.3 million and Codes Enforcement decreased \$0.8 million.

#### CHANGE IN FINANCIAL POSITION DURING YEAR

The overall change in the financial position of Shelby County during fiscal year 2010 was an increase in net assets of approximately \$120.6 million. The County's governmental activities

operated with an increase in net assets of approximately \$123.4 million. The business-type activities had a net decrease of \$2.8 million.

**Financial Analysis of the Government's Funds**

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

**Governmental funds.** The focus of Shelby County's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable resources*. Such information is useful in assessing Shelby County's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. Readers will notice a change in the classifications of fund balances within the governmental funds from previous years. The County chose to implement a new financial accounting standard for FY2010 (GASB Statement No. 54). This standard establishes fund balance categories in a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed on the use of the resources reported in governmental funds. The categories, in order of the constraints, are restricted, committed, assigned and unassigned. More details on these classifications are presented in the Notes to Financial Statements I (D). under "Net Assets and Fund Equity."

As of the end of the current fiscal year, Shelby County's governmental funds reported a combined ending fund balance of \$293,184,033. The components of the balances are:

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
General Fund	\$ 78,157,913	\$ 75,164,958
Debt Service Fund	102,529,235	74,646,920
Special Revenue Funds	<u>11,157,276</u>	<u>21,296,087</u>
Total, except Capital Projects Fund	191,844,424	171,107,965
Capital Projects Fund	<u>101,339,609</u>	<u>(84,323,603)</u>
Total all governmental funds	<u><u>\$ 293,184,033</u></u>	<u><u>\$ 86,784,362</u></u>

There was a \$20.7 million increase in fund balance excluding capital projects. There was an increase of \$3.0 million in the general fund, an increase of \$27.9 million in the debt service fund and a decrease of \$10.1 million in all special revenue funds. There was also an increase of \$185.7 million in the capital projects fund. Each of these changes is discussed below.

The general fund is the chief operating fund of Shelby County and operated with a net increase in fund balance of \$3.0 million, compared to a net increase of \$9.7 million in the previous year. The general fund had an increase in revenue of \$0.7 million and an increase in expenditures of \$5.2 million. The general fund was projected to have a significantly larger increase in fund balance for the year until the County Commission appropriated an extra \$10 million to The Med due to its financial condition. The general fund unassigned fund balance of \$75.7 million is available for spending at the government's discretion.

As a measure of the general fund's liquidity, it may be useful to compare the unassigned fund balance to total fund revenue. Unassigned fund balance represents 21.1% of total general fund revenue. Management is committed to maintaining an unassigned fund balance of the general fund of 15% to 25% of general fund revenue.

The debt service fund has a total fund balance of \$102.5 million, all restricted or committed to be used for the payment of debt service. The net increase in fund balance during the current year was \$27.9 million. This increase resulted from an increase of \$21.6 million in revenue, mostly from property taxes and slightly reduced expenditures.

The fund balance of the capital projects fund fluctuates significantly as funds are borrowed for capital project purposes and are then expended for the projects. This fund balance improved from a deficit of \$84.3 million to a positive balance of \$101.3 million. The increase in fund balance was primarily the result of \$120 million of revenue from issuance of bonds to pay off short-term borrowing and proceeds of a \$55.1 million loan from the State of Tennessee under the Qualified School Construction Bond program; the proceeds of this loan will ultimately be paid to the Shelby County and Memphis City school systems. All fund balances of the capital projects fund are restricted, committed or assigned.

All special revenue fund balances are used for the specific purposes designated by the provider of the funds or the legislation establishing the fees and charges that generate the revenue. The Education Fund, a special revenue fund, had an ending fund balance of \$9.1 million. This balance resulted from more property tax revenue during the year than the expenditure appropriation to the Shelby County and City of Memphis school systems. This restricted fund balance will be paid to the school systems as future appropriations are made.

The grant fund balance decreased further from a negative balance of \$10.1 million at June 30, 2009 to a deficit of \$15.5 million at June 30, 2010; this was caused by an increase in receivables not being received in the time to be considered "available" in FY 2010. Other special revenue funds had a net decrease in fund balances during the year of \$13.9 million, primarily from the \$13.1 million decrease in the Hotel and TDZ Taxes Fund as revenue from previous years were used in the current year. Significant balances at year-end, all positive and all restricted, include \$1.6 million in the Health Services Restricted Fees Fund, \$5.9 million in the Roads and Bridges fund, \$2.4 million in the Hotel and TDZ Taxes Fund and \$6.4 million in the Sheriff Narcotics Fund.

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

The County has three business-type activities; these are essentially self-supporting activities. Two of the activities have historically been able to support themselves; these are the consolidated codes enforcement fund and the fire services fund. However, economic conditions have resulted

in a reduction in construction activities resulting in much lower codes enforcement fees, requiring support from the general fund. During this fiscal year \$1.9 million was transferred from the general fund to maintain the net asset balance of \$2.2 million, of which only \$0.5 million is unrestricted. The fire services fund operates entirely on user fees; the net asset balance increased during this fiscal year by \$118,566 to a balance of \$5.6 million, of which \$3.6 million is unrestricted. The corrections center receives reimbursement from the State of Tennessee for housing State prisoners, which accounts for approximately 80% of the prison population. The general fund provides the remaining cost, excluding depreciation. The Center operated with a decrease of \$3.5 million in net assets to a balance of \$30.1 million, of which \$9.4 million is unrestricted. Overall the net assets of the enterprise funds decreased by \$3.6 million during the year with total net assets at year-end of \$37.9 million, of which \$13.5 million was unrestricted. Unrestricted net assets decreased 16.3% or \$2.6 million.

The County has four internal service funds. These funds are reported using full accrual accounting. *For the government-wide financial statements, these funds are combined with governmental activities.* At June 30, 2010 these funds combined had net assets of \$18.8 million, an increase of \$5.0 million. The group health insurance fund had an increase of \$2.7 million in net assets to total net assets of \$9.4 million. The employer insurance fund had an increase of \$0.7 million to total net assets of \$5.1 million. At year-end the central services fund had net assets of \$1.7 million and the tort liability fund had net assets of \$2.6 million.

**Fiduciary funds.** Shelby County reports three fiduciary funds. The largest is the Shelby County Retirement System. The funds in this trust are available only for retirement benefits of current and retired County employees. The accumulated funds in the retirement system at June 30, 2010 were 97.1% of the currently calculated actuarial liability, meaning the system is almost fully funded. The County provides funding as required each year for the increased liability for benefits being earned by current employees. At June 30, 2010 the Retirement System had net assets held in trust of \$825,764,292.

The Shelby County OPEB Trust was created as of July 1, 2007 to accumulate funds and pay other post-employment benefits to terminated County employees. At June 30, 2010 the Trust had net assets held in trust of \$61.6 million. The ratio of current funding to the actuarial liability improved from 11.8% to 15.1% during the past year.

The County also maintains agency funds for a number of the County's elected "constitutional officers" (those officials designated by the State's constitution). These funds do not belong to the County, but are funds held for others. There are no "fund balances" for agency funds.

### Governmental Fund Budgetary Highlights

Differences between the original budget and the final amended budget and between the final budget and actual results for the general fund can be briefly summarized as follows:

- The revenue budget was increased during the year by \$2.9 million – less than one percent of the original budget. The increases were recorded in state, federal, and local revenue as well as charges for services.

- Actual revenues exceeded the final budget by \$3.0 million – almost 1.0% over the budgeted amount. Actual property tax collections were \$13.8 million (6.6%) more than budgeted as a result of significantly fewer valuation appeals reduction than projected. This favorable variance offset the negative trends in most other revenue categories, with the largest unfavorable variance recorded in interest income as a result of substantially lower interest rates.
- The overall expenditure budget was increased during the year by \$8.4 million, or 2.4%. The primary factor driving the overall increase was the decision to provide additional funding for the Shelby County Health Care Corporation (The Med).
- Actual expenditures were \$7.0 million (2.0%) below the amended budget. Significant personnel savings resulted from a hiring freeze and the elimination of some vacant positions. Savings were also realized from cutbacks and cost containment efforts in most operating account categories. As a result of favorable net variances in both revenues and expenditures, use of the \$12.0 million budgeted for planned change in fund balance became unnecessary.

### 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, 2010 amounts to \$568.9 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and system improvements, machinery and equipment, park facilities, roads and other infrastructure. Additions for the year were \$21.6 million and depreciation was \$28.6 million. Construction in progress as of the end of the current fiscal year was \$14.8 million.

Additional information on Shelby County Government's capital assets can be found in note IV (E) of the Notes to Financial Statements of this report.

Major capital asset events during the current fiscal year included the following:

- Although not recorded as assets of the County, during FY 2010 the County provided capital improvement funding of approximately \$1.9 million to the Memphis and Shelby County school systems.
- Construction of a bicycle and pedestrian trail from Shelby Farms to Tillman Street in Memphis was begun. Costs incurred were approximately \$6.1 million.
- Roadway improvements continued within the County with expenditures of approximately \$1.0 million.
- Renovation work continued at the Criminal Justice Complex, with expenditures of approximately \$0.9 million.
- Construction began on the renovation of the Shelby County Office Building at 157 Poplar Avenue; expenditures on this renovation were approximately \$0.6 million.
- Construction of the Cotton Creek Sewer System was begun. Costs incurred were approximately \$0.5 million.

**Long-term Debt.** At June 30, 2010 Shelby County's general obligation bonded debt (bonds payable) outstanding totaled \$1,707,260,182 which represented approximately 8.7% of assessed

value of taxable property. The County's bonds, loans and notes payable decreased by approximately \$40.6 million (2.3%) 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. During FY 2010 \$120 million of short-term notes were converted to long-term bonded debt.

During FY 2010 the County entered into an agreement with the State of Tennessee. The State issued \$55,120,000 of Qualified School Construction Bonds and loaned the proceeds to the County; the County is making the funds available to the Shelby County and City of Memphis schools for specific capital projects. The County will repay the State over the life of the bonds. Since the loan is a general obligation of the County and is backed by the full faith and credit and unlimited taxing power of the County, the County is reporting the loan with other long-term debt.

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

Moody's	Standard & Poor's	Fitch IBCA, Inc.
Aa1	AA+	AA+

Moody's issues ratings from Aaa to C to designate the relative investment qualities of bonds. The Aa rating is in the second highest of the rating categories. The modifier 1 indicates that the bonds are in the top range of the Aa category. Moody's describes its Aa ratings as "Bonds which are rated Aa are judged to be a high quality by all standards. They are rated lower than the best bond because margins of protection may not be as large as in Aaa or fluctuation of protection elements may be of greater amplitude or there may be other elements present which make the long term risk appear somewhat larger than Aaa securities."

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

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

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

The September 2010 unemployment rate for Shelby County was 9.8%, which compares to the rate of 9.4% for the State of Tennessee and 9.6% for the nation. General economic conditions in the region have been parallel to those across the nation.

The total property tax rate for fiscal 2011 was maintained at the same level as fiscal 2010. Conservative growth in property taxes has been forecasted in the FY11 budget to recognize a trend toward more stability in home values and the overall economy, while allowing for the continuing impact of reappraisal appeals and foreclosures.

For fiscal 2011 budget, general fund revenue growth of 1.9% is projected in comparison to the 2010 amended budget, or 1.0% compared to actual receipts for 2010. General fund total expenditures are budgeted to increase by only 0.4% compared to prior year budget. The FY11 budget includes a 2.0% salary increase for all employees for the first time in the past three years; however, 34 vacant positions are eliminated. A hiring freeze implemented in 2009 has continued as a means of evaluating staffing priorities and personnel expense on an ongoing basis. Small increases in budgeted expenditures are primarily due to health insurance rates, utility costs, the jail medical contract and other post employment benefits. Expenditures include an additional \$10.0 million for the Regional Medical Center to be used as matching funds for \$20.0 million in federal funding for uncompensated care. The County Mayor and Commission are committed to holding general fund expenditures at the same level as projected general fund revenue growth.

Debt service expenditures decreased \$7.7 million in FY 2010, primarily as a result of lower interest rates on the County's variable rate debt. Expenditures are budgeted to increase to \$182.3 million in FY 2010 mainly because of the County's participation in the Qualified School Construction Bond Program. Projections based on the County's five-year capital plan indicate debt service expenditures will slowly decline in future years. The County plans to maintain annual capital expenditures at \$75 million or less.

### **Requests for Information**

This financial report is designed to provide a general overview of Shelby County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Administrator, Department of Finance, Shelby County Government, 160 North Main Street, Suite 1150, Memphis, Tennessee 38103.