



Bill Purcell Mayor

October 31, 2002

To the Citizens of Nashville and Davidson County, Tennessee:

We are pleased to submit the comprehensive annual financial report of the Metropolitan Government of Nashville and Davidson County, Tennessee (the Government) for the fiscal year ended June 30, 2002. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the management of the Government. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the various funds and component units of the Government in accordance with generally accepted accounting principles (GAAP). All disclosures necessary to enable the reader to gain an understanding of the Government's financial activities have been included.

The Government fully adopted GASB Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, GASB Statement No. 37, Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments, an amendment of GASB Statements No. 21 and No. 34, and GASB Statement No. 38, Certain Financial Statement Note Disclosures, in fiscal year 2002. The requirements of these Statements represent a significant change in the financial reporting model used by the Government. In addition to fund financial statements, the Government is required to report government-wide financial statements prepared using the accrual basis of accounting and the economic measurement focus for all funds. Other changes include the establishment of new fund types, the elimination of account groups, a focus on major funds in the basic financial statements, the reporting of infrastructure, the preparation of cash flow statements using the direct method and the inclusion of Management's Discussion and Analysis (MD&A). This new presentation provides users of the Comprehensive Annual Financial Report (CAFR) with additional information to assist in their review of financial position and results of operations.

The Government is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act, as amended, and U. S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Information related to this single audit, including the schedules of federal and state financial assistance, findings and recommendations, and independent auditors' reports on the internal control structure and compliance with applicable laws and regulations, are not included herein but are reported separately.

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In conformity with generally accepted accounting principles, as set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, The Financial Reporting Entity, this report includes all funds of the primary government and all component units. For purposes of this report, the primary government includes all departments and agencies of the Government which are not separate legal entities, including the Department of Water and Sewerage Services and Metropolitan Nashville Public Schools. The component units include those separate legal entities whose relationships with the primary government meet the criteria for inclusion defined in GASB Statement No. 14.

The comprehensive annual financial report is presented in three main sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, a description of the form of government, the Government's organizational chart, a list of principal officials, and an organizational chart for the Government's Finance Department. The financial section includes the independent auditors' report, MD&A, the basic financial statements, notes, required supplementary information, individual fund and component unit statements and schedules. The statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

As noted previously, the Government is required to provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The Government's MD&A can be found immediately following the report of the independent auditors.

PROFILE OF THE GOVERNMENT

Metropolitan Nashville and Davidson County is located in middle Tennessee at the hub of many air, rail, and highway transportation routes. The Government provides a full range of services. These services include education; police and fire protection; waste management; construction and maintenance of highways, streets, and infrastructure; traffic regulation and control; parking; health and social services; public housing; recreational and cultural activities; public libraries; planning and zoning; water and sewerage services; administration of justice; and general administrative services.

FACTORS AFFECTING FINANCIAL CONDITION

The local economy is a well-balanced blend of financial, agricultural, wholesale, retail, manufacturing, and service industries. The local mix of these industries roughly reflects the national economy, with no single industry being predominant in the region. Computer technology, automotive, medical, private educational, private prison management, insurance, banking, publishing, telecommunications, and entertainment companies all find a home in Nashville. With a rich economic, social, and cultural environment, the city consistently scores high in national rankings of preferred business locations, best places to live, and favorable environments for the creation and development of businesses.

The Nashville Metropolitan Statistical Area (MSA) economy has been slightly healthier than the national economy, with lower unemployment than the state and the nation. While the city has been affected by the current national economic situation, we expect no unusual negative effects specific to Nashville or the MSA.

The Government's two most significant locally generated revenue sources are sales and property taxes. The Government is watching the sales tax closely since the collections have been lower than expected. The property tax base has shown moderate growth, and Nashville continues to have the lowest effective property tax rate of the four major Tennessee cities. The Government has no income tax.

MAJOR INITIATIVES

The Government continues to emphasize delivery of focused public services in a way that provides maximum efficiency, effectiveness, and value to the citizens of Nashville. The Government's major initiatives for fiscal year 2002, for fiscal year 2003, and for the future are discussed below.

FOR FISCAL YEAR 2002: Substitute budget ordinance BL2001-707 adopted a balanced budget totaling \$1,230,354,737 in the budgetary funds. The budget included significant service improvements, funded by net increase of \$0.34 per \$100 of assessed value. The combined GSD-USD tax rate was reduced from \$4.24 to \$3.84 per \$100 assessed value. The reduction in the rates of tax levy between fiscal year 2001-02 was the result of a state mandated reappraisal valuation of property in Davidson County. The combined net increase in fiscal year 2001-02 GSD-USD tax rate was from \$4.24 to \$4.58.

The budget continued to focus improvements on areas first articulated in fiscal year 2001, including:

- Public Education – This budget was the first since the completion of the comprehensive performance audit of the school system. The audit initiated by this administration and Metropolitan Nashville Public Schools included more than 200 findings and recommendations. The budget addressed the recommendations of that audit including the first step in a sustained investment for the operations of Metro schools. The \$34 million in new funds for schools in this budget provided 114 new teachers in the system and allowed a reduction in class size to meet state requirements. The property tax increase for schools generated more revenue the first year than was needed in FY 2002; the anticipated surplus will be needed to help fund the FY 2003 and FY 2004 schools budgets.
- Public Safety – The Police Department’s mission is to provide community based police services promote a safe and peaceful Nashville. We continued to focus on the importance of retention and recruitment in the police department, and the budget included more than \$8.5 million in pay plan and benefits adjustments to bring salaries in line with pay in comparable cities. Similar improvements were made for our fire and other emergency personnel. The Fire Department and other public safety and justice administration enhancements totaled \$7.6 million.
- Neighborhoods and Community Support – The first-ever Mayor’s Office of Neighborhoods was created to foster an environment where neighborhoods are empowered to solve problems and participate with city government in addressing issues of mutual concern, to improve the quality of life in Nashville’s neighborhoods through more active and involved citizens, and to enhance governmental response to community needs. The budget included \$100,000 in new funds to provide neighborhood enhancement grants for neighborhood organizations. Beyond that, the budget also included improvements totaling \$6.5 million in libraries, parks, arts, Head Start, the zoo, and other community programs.
- Keeping our Commitments – The budget included almost \$17 million in required funding to meet commitments, including employee benefits, sports facilities, one-time funds to facilitate the Nashville Public Television spin-off from Metropolitan Nashville Public Schools, and anticipated utility cost increases.
- Valuing our Employees – The budget implemented pay increases after a compensation study performed by William M. Mercer, Inc. The study recommended general reclassifications, together with general pay increases in each of the next three years. This budget fully funded these recommendations, costing over \$30 million (\$24.6 million in the general funds) in FY 2002.

FOR FISCAL YEAR 2003: Substitute budget ordinance BL2002-1073 adopted a balanced budget totaling \$1,312,208,694 in the budgetary funds, an increase of 6.7% over the budget for fiscal year 2002. The budget included some service improvements, but no change in property tax rates.

The budget continues to make improvements in our focus areas, including:

- Public Education – Over the last year, Metropolitan Nashville Public Schools developed and approved a systemwide strategic plan for 2002-2007, and created a 2003 Student-Based Budget. The Metro budget advances both the mission and the funding recommendations of that budget, partly through new expenditures and partly through redirecting existing funds. Funds were directed toward more staff, innovative programs, technology, books, supplies, materials, maintenance, and compensation. The budget also continued the systematic plan to fully implement the recommendations of the comprehensive performance audit.

- Public Safety – Metro continues to focus on assuring that our citizens are safe by providing the necessary personnel, training, and equipment to our Police, Fire, Office of Emergency Management and related Health programs. The 2003 budget targets funding for overtime in both the Police and Fire Departments, supports the implementation of most recommendations from the recent Police performance audit, and includes the hiring of School Resource Officers and other improvements related to public safety and homeland security.
- Neighborhoods and Community Support – The continuing focus on supporting our neighborhoods and striving to ensure a high quality of life cuts across all of our priorities. Particular efforts include a new household recycling program throughout the Urban Services District, a continued emphasis on creating safe and affordable housing in our neighborhoods, master plan for sidewalks (which will guide unprecedented levels of sidewalk construction), the Parks master plan (which will guide our investments in parks, greenways and the like as we enter the second 100 years of our Parks system), and funding for Public Works performance audit recommendations.
- Valuing our Employees – The budget provides funds for 3% overall pay increases, normal pay increments, and increased fringe benefits and medical insurance costs in FY 2003.
- Other Enhancements – The budget also calls for management improvements and changes, including consolidation of fleet management activities into a new Fleet Management Office and consolidation of stormwater activities in the Department of Water and Sewerage Services.
- Results Matter – in FY 2002, Metro began deploying a government-wide strategic planning and performance measurement initiative through the Office of Management and Budget in the Department of Finance. The initiative, called “Results Matter,” seeks to introduce the managing for results methodology into the systems and culture of all parts of Metro government. This will be accomplished by a multi-year implementation of a Strategic Business Planning process across all departments; that process has begun with eleven departments in calendar year 2002. Once implemented, this initiative will help to provide tools and data needed to focus on delivering results for customers, and managerial systems and the organizational culture will focus on those results.

These initiatives will be addressed while ensuring the government meets its fundamental objectives of maintaining balanced budgets, keeping taxes low, and investing in Nashville’s future. Details of all improvements included in the fiscal year 2002 and 2003 budgets are described in the annual *Operating Budget* books and in the *Budget in Brief* booklets published by the Department of Finance, Office of Management and Budget. They are also available on the internet at www.nashville.gov.

FOR THE FUTURE: In coming years, the Government's agenda will focus on efforts to:

- Continue improving public education. Although improvements have been made in recent years, the work of our schools will involve the whole community's attention, time, and commitment to the public school system we know we must have.
- Continue to focus on our neighborhoods, on their safety and their unity, through the Office of Neighborhoods, the Police department, and other departments of the Government.
- Continue to focus on the issues underlying our quality of life. This includes economic and community development, parks, the arts, libraries, adequate public transportation and affordable housing.
- Review the structures, procedures, and management of the Government to ensure the most effective, efficient services to its citizens.

These issues will be successfully resolved by the ongoing cooperation of business, government, citizen groups, and other involved parties. The Government's budget continues to stress sound financial management and efficiency, effectiveness, and equity in public services. It remains committed to building a future in which all citizens of Davidson County can enjoy economic prosperity and a quality lifestyle.

FINANCIAL INFORMATION

CASH MANAGEMENT: Cash temporarily idle during the year was primarily invested in demand deposits, certificates of deposit, obligations of the U. S. Treasury, commercial paper, and the State of Tennessee Local Government Investment Pool. Investments are made either directly or through the Metro Investment Pool. Investments in the pension trust funds also include common stocks, corporate bonds and other holdings.

The Government's investment policy is to preserve principal, minimize credit and market risks, and maintain adequate liquidity while maximizing the rate of return on its portfolio. The investment policy encourages conservative, low risk investments and does not permit more risky methods, such as leveraging, to enhance investment returns. The majority of the cash deposits are held by financial institutions participating in the bank collateral pool administered by the State of Tennessee, thus ensuring that they are collateralized. Earnings continue to be realized as a result of the banking service agreement, which in part provides for the daily investment of demand deposit balances.

The primary government earned investment income of \$31.8 million for the year ended June 30, 2002.

RISK MANAGEMENT: The Government continued to operate a risk management program, which was initiated in 1978. As part of its comprehensive plan, resources are being accumulated in various internal service funds to meet potential losses. Accepted risk control techniques, including employee accident prevention training, have been implemented to minimize potential liability losses. In addition, the Government has elected to come under the Tennessee Tort Liability laws in order to limit its potential liability.

PENSION TRUST FUNDS: The pension system of the Government covers substantially all full-time employees. It consists of one pension plan that is open to new members and five pension plans that are closed to new members but are still used by some employees of the former City of Nashville, the former Davidson County, and Metropolitan Nashville Public Schools.

After recognizing contributions from other funds, employees, and the State of Tennessee, the General Fund is responsible for amounts necessary to fund the Metropolitan Employees' Benefit Trust Fund (which includes Division A, the closed plan, and Division B, the open plan) and the following four closed plans:

- The County Plan - Davidson County Employees' Retirement Fund
- The County Education Plan - Employees' Pension and Insurance Fund
- The City Plan - Closed City Plan Fund
- The City Education Plan - Teachers' Civil Service and Pension Fund

After recognizing contributions from employees and the State of Tennessee, Metropolitan Nashville Public Schools is responsible for funding the Metro Education plan – The Teachers' Retirement Plan Fund. The total assets of all pension funds were \$1.5 billion at June 30, 2002.

INTERNAL CONTROL STRUCTURE: Management of the Government establishes and maintains an internal control structure designed to ensure that the assets of the Government are protected from loss, theft, or misuse and to ensure that adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

BUDGETARY CONTROLS: The Government maintains budgetary controls in order to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Government's governing body, the Metropolitan Council. Activities of the General Fund, General Purpose School Fund and the General Purposes and School Purposes Debt Service Funds are included in the annual appropriated budget. The Government maintains an encumbrance accounting system to provide management with information regarding obligations against appropriations. Budgetary compliance is based on expenditures during the period (GAAP), rather than expenditures and encumbrances (non-GAAP). The annual appropriated budget for the General Purpose School Fund continues to measure expenditures and encumbrances against appropriations (non-GAAP). Encumbrances outstanding at June 30, 2002 are reported as reservations of fund balance for subsequent year expenditures.

SINGLE AUDIT: As a recipient of federal and state financial assistance, the Government is responsible for ensuring that an adequate internal control structure is in place to ensure compliance with applicable laws and regulations related to those programs. As part of the Government's single audit, tests are performed to determine the adequacy of the internal control structure, including that portion related to federal and state financial assistance programs, as well as to determine that the Government has complied, in all material respects, with applicable laws and regulations. The results of the Government's single audit for fiscal year 2002, including any reported instances of weaknesses in the internal control structure or any violations of applicable laws and regulations, are reported separately.

OTHER INFORMATION

INDEPENDENT AUDIT: Section 6.15 of the Metropolitan Charter requires an annual audit of accounts and other evidences of financial transactions of the Government and of its departments, offices, and agencies by independent certified public accountants. The audit is performed by a firm chosen by a three-member audit board consisting of the Vice-Mayor, the Chairman of the Budget and Finance Committee of the Metropolitan Council, and the Chairman of the Metropolitan Nashville Public Schools. This requirement has been complied with; the independent auditors' report and the non-major governmental, non-major enterprise, internal service and fiduciary funds' statements and schedules are included in the financial section of this report.

AWARDS: The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Government for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2001. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR and conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

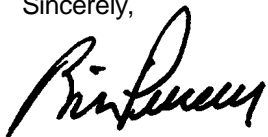
A Certificate of Achievement is valid for a period of one year only. The Government has received a Certificate of Achievement for the last nineteen years. We believe this report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

The GFOA presented a Distinguished Budget Presentation Award to the Government for its annual budget for the fiscal year beginning July 1, 2002. In order to receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan, and as a communications device. The award is valid for a period of one year only. We believe the current budget continues to conform to program requirements, and we are submitting it to the GFOA. It is the Government's twelfth year to receive this award.

ACKNOWLEDGMENTS: Many individuals and organizations throughout the Government assisted in preparing this CAFR. To each of them we gratefully express our sincere appreciation for their dedicated contributions.

Finally, we appreciate the support of the Metropolitan Council in the continued financial management of the Government.

Sincerely,



Bill Purcell
Mayor



David L. Manning
Director of Finance