

October 31, 2003

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, 2003. 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 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.

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, management's discussion and analysis (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 2003, for fiscal year 2004 and for the future are discussed below.

**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 continued to make improvements in our focus areas, including:

- **Public Education** – Metropolitan Nashville Public Schools developed and approved a systemwide strategic plan for 2002-2007 and created a 2003 Student-Based Budget. The budget advanced 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 implement the recommendations of the comprehensive performance audit issued January 26, 2001.
- **Public Safety** – Metro continued 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 targeted funding for overtime in both the Police and

- Fire Departments, supported the implementation of most recommendations from the recent Police performance audit, included the hiring of School Resource Officers and included 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 cut across all of our priorities. Particular efforts included a new household recycling program throughout the Urban Services District, a continued emphasis on creating safe and affordable housing in our neighborhoods, a master plan for sidewalks (which guides unprecedented levels of sidewalk construction), the Parks master plan (which guides 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 provided 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 called for management improvements and changes, including consolidation of fleet management activities into a new Office of Fleet Management and consolidation of stormwater activities in the Department of Water and Sewerage Services.
- Results Matter – In fiscal 2002, Metro began deploying the government-wide “Results Matter” strategic planning and performance measurement initiative. The initiative, coordinated through the Office of Management and Budget in the Department of Finance, introduced the managing for results methodology into the systems and culture of all parts of Metro government. Implementation is being staged in a series of “waves”. To begin the process, an agency develops a strategic business plan using a specific methodology and process; the plan is focused around measurable performance results for customers. When the plan is complete, the agency’s budget is restructured into a program-based performance-informed budget that mirrors the structure of the strategic plan. An employee performance measurement system is being deployed to support the goals and objectives of the agency and program performance measures are being reviewed by the Internal Audit Section. As a result, the agency’s culture, financial structure and performance metrics support results for its customers.

FOR FISCAL YEAR 2004: Substitute budget ordinance BL2003-1471 appropriated a balanced budget totaling \$1,352,210,300 in the budgetary funds, an increase of 3.05% over the fiscal year 2003 budget ordinance. The budget included some service improvements but no change in property tax or local option sales tax rates despite state-shared tax cutbacks in the State of Tennessee’s budget.

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

- Public Education - The Metro Board of Public Education continues to implement a system-wide strategic plan for 2003-2008 with a vision "to become the top-performing school district in the nation." The 5.3% budget increase advances the Board’s mission through new expenditures and redirecting existing funds. The budget adds middle school teachers, guidance counselors, assistant principals, English Language Learner teachers, campus supervisors, bus drivers, school custodians and maintenance personnel; increases funds for textbooks, technology and technology support, supplies, parental communication efforts and strategic plan surveys; provides funds to open new schools and to implement the School Improvement Plan program; and funds increased costs for employee insurance and pensions.
- Public Safety – The budget consolidates Police and Fire communications into an Emergency Communications Center; adds funds for Police overtime pay for community policing, traffic calming, special events, training, radio equipment, school crossing guards and School Resource Officers; adds funds for operating the new North Nashville precinct; funds the Sheriff Department’s Day Reporting Center; funds costs related to the temporary relocation of courts during the Metro Courthouse renovation; funds Fire Department paramedic cross-training; and creates a Criminal Justice Population Projection Unit to help manage jail inmate populations.

- Neighborhood and Community Support - The budget continues to directly focus on our daily lives. It increases funding for Health Department immunization staff, the Medical Examiner's Office contract, Park Rangers, contributions to the arts and Human Relations compliance enforcement and other improvements; makes direct contributions to Neighborhood Aftercare, the Second Harvest Food Bank, United Way Family Resource Centers and Health Care Access / Bridges to Care; and opens all branch libraries on Friday.
- Valuing our Employees – The budget provides funds for 3% overall pay increases, normal pay increments, and increased fringe benefits and medical insurance costs in fiscal 2004.
- Other Enhancements – The budget also calls for management improvements and changes, including rent for temporary court facilities while the Courthouse renovation is underway; additional funding for the Metropolitan Transit Authority; increases in correctional health services costs; and utility contingencies.
- Results Matter – Eleven “Wave One” agencies representing about half of general fund expenditures and employees were implemented in FY 2003 with their first reformatted budgets effective in fiscal 2004. Thirteen “Wave Two” agencies, including the Department of Water and Sewerage Services, are being implemented in fiscal 2004 with their first program budgets anticipated in fiscal 2005 and 2006. Combined, these two waves constitute most of our operating expenditures and employees.

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 2003 and 2004 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 GFOA-award-winning Citizen's Guide to the Budget at the [www.nashville.gov](http://www.nashville.gov) internet site.

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.
- Continue to focus on our neighborhoods and on their safety and 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 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 \$18 million for the year ended June 30, 2003.

**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 (and other employee benefit) trust funds were \$1.5 billion at June 30, 2003.

**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). Encumbrances outstanding at June 30, 2003 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 2003, 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. The Government has complied with this requirement. 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, 2002. 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 twenty 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, 2003. 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. It is the Government's thirteenth year to receive this award.

The GFOA also presented the Metropolitan Government with one of only three 2003 Awards for Excellence in Government Finance. The award for "e-government and Technology (Subcategory: Communications and Reporting)" was for our FY 2003 Citizens' Guide to the Budget at the 'www.nashville.gov' internet site.

**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.

In conclusion, we acknowledge and express our appreciation for the strong support of the Metropolitan Council. The Council's support will continue to be vital as we work to further strengthen the financial management of the Metropolitan Government.

Sincerely,

Bill Purcell  
Mayor

David L. Manning  
Director of Finance