

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

As management of the County, we offer this narrative overview and analysis of the financial activities of the County for the year ended December 31, 2005. Readers are encouraged to read it in conjunction with the letter of transmittal, which is located at the beginning of this report, and the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The assets of the County exceeded its liabilities by \$366.7 million at year-end.
- The net assets of the County increased by \$16.8 million in fiscal 2005. Of this increase, \$24.1 million is restricted in its use as a replacement for State Revenue Sharing payments.
- The General Fund reported a loss of \$9.1 million for the year. Unreserved fund balance was \$53.3 million, or 12.0% of the total 2006 County operating budget. Total fund balance was \$53.6 million.
- The County maintained its AAA credit rating with Standard & Poors and its Aaa rating with Moody's Investor Service.
- The County issued \$19.4 million in bonds for the construction of a new District Court facility in the City of New Baltimore and the construction of a high frequency emergency radio communications system.
- The County advance refunded \$2.7 million in bonds, resulting in long-term interest savings of approximately \$.1 million.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of a series of financial statements: 1) government-wide financial statements, which focus on the County as a whole, 2) fund financial statements, which provide a more detailed view of the County's major funds and 3) notes to the financial statements, which provide additional information that is essential to gain a full understanding of the data presented in the financial statements.

Government-wide financial statements consist of the *Statement of Net Assets* and the *Statement of Activities* and provide readers with a broad overview of the activities of the County as a whole. One of the more important questions citizens and other readers of the financial statements often ask is "Is the County as a whole better or worse off this year than it was a year ago?" In other words, did the financial condition of the County improve or decline over the course of the past year. The government-wide statements report information in a manner that is intended to help answer these questions.

The government-wide statements are prepared using the full accrual basis of accounting, which is similar to that employed by businesses in the private sector.

The *Statement of Net Assets* presents information on all of the assets and liabilities of the County, with the difference between the two reported as *net assets*. Net assets can be thought of as one way of measuring the financial strength of the County. Increases or decreases in net assets over time may serve as a useful indicator of whether the financial condition of the County is improving or deteriorating.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

Non-financial factors such as changes in the property tax base, population and condition of roads and bridges must also be considered when assessing the financial condition of the County.

The *Statement of Activities* presents information showing how the net assets of the County have changed over the course of the most recent fiscal year. All changes in net assets are recognized as soon as the underlying transactions take place, regardless of the timing of the related cash flows. As a result, certain revenues and expenses reported in these statements are related to items that will only result in cash flows in future years. Examples of such items are uncollected property taxes and earned but unused sick and vacation leave.

The government-wide financial statements segregate the activities of the County into three categories: 1) governmental activities, business-type activities and discretely presented component units. The basic services of the County are classified as **governmental activities** and are financed primarily through property taxes, user fees and intergovernmental revenues. Functions reported in this category include general government, legislative, health and welfare, law enforcement and judicial. **Business-type activities** operate like private businesses and are intended to recover the majority of their costs through user fees. The business-type activities of the County include the Delinquent Tax Revolving Funds, Martha T. Berry Medical Care Facility, Community Mental Health and the Freedom Hill Park. **Discretely presented component units** are legally separate entities, the majority of whose governing bodies are appointed by the Board of Commissioners and for which the County is financially accountable. The County reports the Road Commission, Macomb/St. Clair Workforce Development Board, the Public Works Commission and the County of Macomb Hospital Finance Authority as discretely presented component units.

The government-wide financial statements begin on page B-1 of this report.

Fund financial statements are separate groupings of related accounts that are used to maintain control over resources that have been segregated for specific purposes. Each fund of the County is considered a separate accounting entity for which a self-balancing set of accounts is maintained. Certain funds are established in accordance with State law while others are required by bond or grant agreements or are established at the discretion of management to enable it to more easily manage and report on the activities of the many programs of the County. All the funds of the County can be divided into one of three categories: governmental, proprietary or fiduciary.

Governmental funds are used to account for most of the basic services provided by the County and report essentially the same functions as those reported as governmental activities in the government-wide financial statements. Governmental funds are accounted for using the *modified accrual* basis of accounting, which focuses on the short-term inflows and outflows of cash and other financial assets that can be readily converted into cash and the balances of them available for spending at year-end. Because the focus of the governmental fund financial statements is narrower in scope than that of the government-wide financial statements, reconciliations are provided in both the governmental fund balance sheet and operating statement to help the reader better understand the relationship between the two.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

All of the governmental funds of the County are categorized as either major or nonmajor for presentation in the financial statements. The purpose of such segregation is to focus the attention of the reader on the more significant funds of the County. A fund is considered major if its assets, liabilities, revenues or expenditures meet or exceed certain percentage thresholds in relation to all governmental funds taken as whole. The thresholds used to determine a fund's status as major or nonmajor are set forth in GASB Statement No. 34.

Information regarding major funds is presented separately in the basic financial statements while data for all nonmajor funds is combined into a single, aggregated presentation. The General Fund and the Revenue Sharing Reserve Fund are the only major governmental funds of the County. Individual fund data for each of the nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

Proprietary funds are classified as either enterprise funds or internal service funds and are accounted for using the full accrual basis of accounting. *Enterprise funds* are used to report the same functions as those presented as business-type activities in the government-wide financial statements and include the Delinquent Tax Revolving Fund, Community Mental Health Fund, Freedom Hill Park Fund and the Martha T. Berry Medical Care Facility Fund. *Internal service funds*, on the other hand, are used to centrally account for services provided to other County departments and include phone services, fleet management, copier replacement, workers' compensation insurance, general liability insurance and compensated absences. Because the internal service funds predominately benefit governmental rather than business-type functions, they have been included within the governmental activities in the government-wide financial statements. Data regarding the internal service funds has been combined into a single, aggregated presentation in the basic financial statements. Information regarding the individual internal service funds is provided in the form of combining statements elsewhere in this report.

The proprietary fund financial statements begin on page B-8 of this report.

Fiduciary funds are used to account for resources held by the County on behalf of others, including those of the Employee Retirement System and the Retiree Health Care Trust as well as other agency monies such as state education tax collections from local units of government. The activities of the fiduciary funds are presented separately in this report but are not reflected in the government-wide financial statements because the resources of those funds are not available to support the operations of the County. Fiduciary funds are accounted for using the full accrual basis of accounting.

The fiduciary fund financial statements begin on page B-14 of this report.

Notes to the Financial Statements provide additional information that is essential to gain a full understanding of the data presented in both the government-wide and fund financial statements and begin on page B-19 of this report.

Required Supplementary Information is presented following the notes to the financial statements and includes schedules regarding the progress of the County in funding its pension obligations and a budget to actual comparison for the major governmental funds of the County.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

Required supplementary information begins on page C-1 of this report.

Combining and individual funds statements of the nonmajor funds of the County are presented immediately following the required supplementary information and begin on page D-1 of this report.

FINANCIAL ANALYSIS OF THE COUNTY AS A WHOLE

The financial analysis of the County as a whole focuses on the net assets and changes in net assets of the governmental and business-type activities of the County. As noted earlier, net assets and changes in net assets may serve as one indicator of the financial health of the County. The assets of the County exceeded its liabilities by \$366.7 million at December 31, 2005 and increased by approximately \$16.8 million for the year then ended.

Macomb County Primary Government Net Assets

	Governmental Activities		Business-type Activities		Totals	
	2004	2005	2004	2005	2004	2005
Current and other assets	\$ 274,379,310	\$ 259,303,329	\$ 100,330,992	\$ 105,372,219	\$ 374,710,302	\$ 364,675,548
Capital assets	157,536,562	166,461,655	2,556,498	6,744,652	160,093,060	173,206,307
Total assets	431,915,872	425,764,984	102,887,490	112,116,871	534,803,362	537,881,855
Current liabilities	97,469,514	63,392,269	8,818,072	15,100,374	106,287,586	78,492,643
Long-term liabilities	78,605,406	92,728,531	-	-	78,605,406	92,728,531
Total liabilities	176,074,920	156,120,800	8,818,072	15,100,374	164,892,992	171,221,174
Net assets						
Invested in capital assets, net of related debt	103,036,562	110,591,655	2,556,498	6,744,652	105,593,060	117,336,307
Restricted	64,780,560	97,573,310	6,354,358	6,411,028	71,134,918	103,984,338
Unrestricted	88,023,830	61,479,219	85,158,562	83,860,817	173,182,392	145,340,036
Total Net Assets	\$ 255,840,952	\$ 269,644,184	\$ 94,069,418	\$ 97,016,497	\$ 349,910,370	\$ 366,660,681

Approximately \$117.3 million, or 32.0% of the County's net assets represents its investment in capital assets, net of any outstanding debt used to acquire those assets. These assets are used by the County to provide services to the public; consequently, they are not available for future spending. Although the County's investment in its capital assets is reported net of any related debt, it should be noted that the resources needed to repay this debt must be provided from other sources since the assets themselves cannot be used to liquidate the outstanding debt obligations. Another \$104.0 million, or 28.4%, of the County's net assets represents resources that are subject to external restrictions regarding their use. Approximately 50% of the net assets included in this category represent the net assets of the Revenue Sharing Reserve Fund. The remaining balance of the County's net assets are unrestricted and may be used to meet the County's ongoing obligations. Positive balances in all three categories are reported at December 31, 2005.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

As indicated in the following schedule, the net assets of the County increased by \$16.8 million for the year ended December 31, 2005. The components of this change were an increase of \$13.8 million in governmental activities and an increase of \$3.0 million in business-type activities. The components of these changes are discussed in the following section.

Macomb County Primary Government Changes in Net Assets

	Governmental Activities		Business-type Activities		Totals	
	2004	2005	2004	2005	2004	2005
Revenues						
Program revenue						
Charges for services	\$ 46,441,446	\$ 47,465,835	\$ 154,126,501	\$ 158,372,941	\$ 200,567,947	\$ 205,838,776
Operating grants and contributions	50,190,070	54,003,340	357,944	288,451	50,548,014	54,291,791
Capital grants and contributions	3,197,973	1,538,463	-	-	3,197,973	1,538,463
General revenue						
Property taxes	145,946,433	153,325,600	-	-	145,946,433	153,325,600
Intergovernmental revenues	8,260,654	2,435,590	-	-	8,260,654	2,435,590
Investment income	3,432,645	6,456,366	1,052,437	1,856,037	4,485,082	8,312,403
	<u>257,469,221</u>	<u>265,225,194</u>	<u>155,536,882</u>	<u>160,517,429</u>	<u>413,006,103</u>	<u>425,742,623</u>
Expenses						
Legislative	1,958,277	2,076,701	-	-	1,958,277	2,076,701
Judicial	32,738,381	37,466,334	-	-	32,738,381	37,466,334
General government	49,414,817	52,597,031	865,989	702,662	50,280,806	53,299,693
Public safety	60,512,543	67,117,931	-	-	60,512,543	67,117,931
Public works	2,133,523	953,845	-	-	2,133,523	953,845
Health and welfare	71,578,296	76,036,023	157,780,177	163,185,851	229,358,473	239,221,874
Recreation and culture	2,982,626	2,976,004	1,130,182	1,131,003	4,112,808	4,107,007
Interest and fees on long-term debt	3,423,082	3,762,691	-	-	3,423,082	3,762,691
	<u>224,741,545</u>	<u>242,986,560</u>	<u>159,776,348</u>	<u>165,019,516</u>	<u>384,517,893</u>	<u>408,006,076</u>
Increase (decrease) in net assets before transfers	32,727,676	22,238,634	(4,239,466)	(4,502,087)	28,488,210	17,736,547
Net transfers	(1,974,217)	(8,435,402)	2,655,143	7,449,166	680,926	(986,236)
Increase (decrease) in net assets	30,753,459	13,803,232	(1,584,323)	2,947,079	29,169,136	16,750,311
Net assets, beginning of year	<u>225,087,493</u>	<u>255,840,952</u>	<u>95,653,741</u>	<u>94,069,418</u>	<u>320,741,234</u>	<u>349,910,370</u>
Net assets, end of year	<u>\$ 255,840,952</u>	<u>\$ 269,644,184</u>	<u>\$ 94,069,418</u>	<u>\$ 97,016,497</u>	<u>\$ 349,910,370</u>	<u>\$ 366,660,681</u>

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

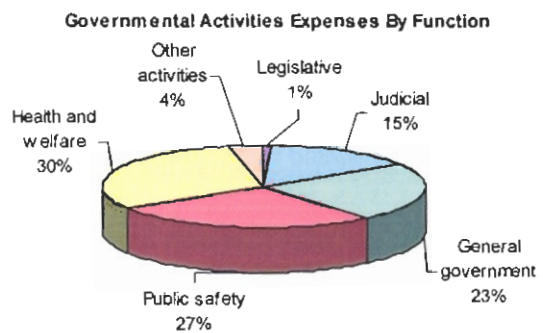
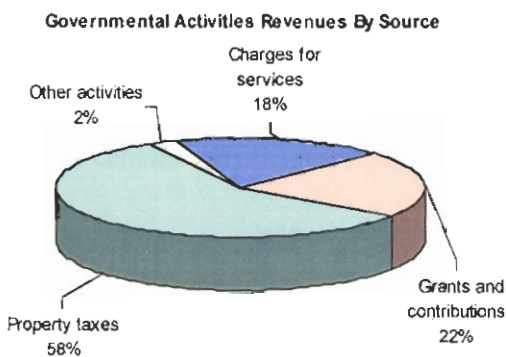
Governmental activities. Key components of the \$13.8 million increase in the net assets of the County's governmental activities in 2005 are as follows:

- Property tax revenue increased by \$7.4 million, or 5.1%, as a result of increases in property values throughout the County.
- Charges for services increased \$1.0 million, or 6.4%, primarily the result of the Sheriff Department contracting with the City of Mount Clemens to provide police and dispatching services beginning in July 2005.
- Intergovernmental revenues decreased \$5.8 million, the majority of which was the result of a \$4.7 million reduction in State Revenue Sharing payments, which were phased out by the State of Michigan in 2004. Public Act 357 was enacted by the State legislature in 2004 to serve as a substitute funding mechanism for State Revenue Sharing. Under its provisions, the collection of property taxes will be accelerated over the course of three years, whereby the County will eventually levy 100% of its property taxes in July rather than December. This gradual shift will take place as follows: 1/3 of the 2005 County levy was made in July 2005, 2/3 of the 2006 levy will be made in July 2006 and 100% of the 2007 levy will be made in July 2007. Each year thereafter, 100% of the levy will be made in July. Beginning in 2004, three annual installments, each equal to 1/3 of the December 2004 property tax levy, will be recognized as revenue and placed in a restricted fund known as the Revenue Sharing Reserve Fund. Beginning in 2004, and each year thereafter until its fund balance is exhausted, the Revenue Sharing Reserve Fund will transfer to the General Fund each year an amount determined by the State of Michigan that approximates the amount of revenue sharing that would have been distributed by the State in fiscal 2004 if it not been discontinued. The fund balance of the Revenue Sharing Reserve Fund is expected to be exhausted in 2011. The amount placed in the Revenue Sharing Reserve Fund in 2005 was \$37.7 million, of which \$14.1 million was subsequently transferred to the General Fund.
- Judicial expenditures increased \$4.7 million, or 14.4%, of which \$1.6 million was due to an increase in court appointed attorney fees. In 2004, the County performed an analysis of its accrual for unbilled fees and determined that a downward adjustment was warranted. As a result, the accrual was reduced by approximately \$1.3 million, which in turn resulted in an increase in 2005 over the prior year. Actual expenses incurred in 2005 were consistent with the previous four to five years, exclusive of the accrual adjustment. The remaining judicial expenditure increase of \$3.4 million was due primarily to increases in salaries and fringe benefits.
- Public safety expenses increased by \$6.6 million, or 10.9%, compared to the prior year, of which \$4.6 million was experienced in the Sheriff Department. The Sheriff Department began contracting with the City of Mount Clemens to provide police and dispatching services in July 2005, which required the addition of 27 positions to the budget, thereby resulting in additional expenses of \$1.1 million over the prior year. The remaining increase of \$3.5 million, or 5.8%, was caused by increases in salaries and fringe benefits.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

- Health and welfare expenditures increased by \$4.4 million, or 6.2% over the prior year, \$2.2 million of which relates to the Health Department. The increase experienced at the Health Department has three basic components: increases in the costs associated with salaries and fringe benefits of roughly \$1.0 million, an increase of approximately \$.7 million in the cost of pharmaceutical drugs and another \$.5 million in design and engineering fees incurred in conjunction with a new morgue facility. The remaining \$2.2 million increase in Health and Welfare expenditures can be attributed to increases in salaries and fringe benefits.

The components of the County's governmental revenues and expenditures are presented below.



Business-type activities. The net assets of the County's business-type activities increased approximately \$2.9 million during the year. The majority of this increase is attributable to a \$4.1 million surplus at the Martha T. Berry Medical Care Facility and a \$1.2 million deficit in the Delinquent Tax Revolving Fund. The surplus at Martha T. Berry is due to transfers totaling \$4.4 million that represent the cost of capital assets of Martha T. Berry that were paid for from the governmental capital projects funds. The restricted fund equity of Martha T. Berry has been increased to reflect the capitalization of these assets in the accounts of Martha T. Berry. The unrestricted equity of Martha T. Berry decreased \$.1 million in fiscal 2005. The deficit in the Delinquent Tax Revolving Fund was due primarily to a decrease in collection fees associated with the delinquent tax rolls.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

FINANCIAL ANALYSIS OF THE COUNTY'S MAJOR FUNDS

Governmental funds. As previously mentioned, the focus of governmental funds is to provide information on near-term inflows, outflows and remaining balances of spendable resources. Such information is useful in assessing the County's ability to meet its current financing requirements. The fund balance of governmental funds is segregated into one of three categories: reserved, designated and unreserved. Reserved fund balance represents that portion of the net assets that may only be spent for specific purposes and are not available for new spending. Examples of fund balance reserves include amounts required to pay debt service, bond proceeds that may only be spent on projects for which the bonds were issued and amounts required to meet long-term contractual commitments and encumbrances.

Fund balance designations are established to represent that portion of net assets that are intended to be spent for certain purposes and differ from fund balance reserves in that they can be redirected and used for new spending if necessary. Unreserved fund balance represents the portion of net assets that is available at year-end for new spending.

The combined ending fund balances of all governmental funds was \$176.5 million at December 31, 2005, an increase of \$21.2 million over the prior year. The \$21.2 million increase consists of a \$9.1 million decrease in the General Fund, a \$24.0 million increase in the Revenue Sharing Reserve Fund, a combined increase of \$1.0 million in the Special Revenue and Debt Service funds and a \$5.3 million increase in the Capital Projects funds.

General Fund - The General Fund is the primary operating fund of the County. All revenues and expenditures are recorded in the General Fund unless otherwise required by statute, contractual agreement or policy. A year-to-year comparison of General Fund revenues by source is presented below.

General Fund Revenue By Source

<u>Source</u>	<u>2004</u>	<u>2005</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
Taxes	\$ 108,024,702	\$ 115,340,337	\$ 7,315,635	6.8%
Licenses and permits	397,172	391,395	(5,777)	-1.5%
Federal and State grants	14,756,398	8,421,712	(6,334,686)	-42.9%
Charges for services	26,754,510	30,297,038	3,542,528	13.2%
Investment income	2,564,527	4,703,646	2,139,119	83.4%
Admin charges to other funds	10,516,996	11,087,868	570,872	5.4%
Fines and forfeitures	1,058,973	1,045,629	(13,344)	-1.3%
Other revenue	206,739	166,929	(39,810)	-19.3%
Transfers from other funds	19,668,740	22,724,515	3,055,775	15.5%
	<u>\$ 183,948,757</u>	<u>\$ 194,179,069</u>	<u>\$ 10,230,312</u>	5.6%

The \$7.3 million increase on property tax revenue represents a 6.8% increase over the prior year and is due to the continued increase in taxable values throughout the County.

**MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information**

The \$6.3 million decrease in Federal and State grants can be attributed primarily to the elimination of revenue sharing payments from the State of Michigan as discussed previously.

The increase in charges for services revenue of just over \$3.5 million is the primarily the result of a new contract negotiated between the Sheriff Department and the City of Mount Clemens to provide law enforcement and dispatching services to the City as well as internal charge-backs made by the Facilities and Operations department for repairs and maintenance performed by skilled trades personnel.

Investment income increased approximately \$2.1 million as market interest rates continued to recover in 2005.

Transfers from other funds increased approximately \$3.1 million over the prior year, primarily as a result of an increase in the transfer from the Revenue Sharing Reserve Fund, as previously discussed.

A year-to-year comparison of General Fund expenditures by function is presented below.

General Fund Expenditures By Function

Function	2004	2005	Increase (Decrease)	% Change
Legislative	\$ 1,958,277	\$ 2,076,701	\$ 118,424	6.1%
Judicial	19,451,435	22,779,494	3,328,059	17.1%
General government	48,848,120	54,425,059	5,576,939	11.4%
Public safety	51,927,325	56,691,858	4,764,533	9.2%
Health and welfare	775,974	712,784	(63,190)	-8.1%
Other	4,732,839	5,480,571	747,732	15.8%
Capital outlay	722,119	802,454	80,335	11.1%
Transfers to other funds	58,307,955	60,347,238	2,039,283	3.5%
	<u>\$ 186,724,044</u>	<u>\$ 203,316,159</u>	<u>\$ 16,592,115</u>	8.9%

The \$3.3 million increase in Judicial expenditures is the result of increases in salaries and fringe benefits as well as an increase in court appointed attorney fees as discussed previously.

The \$5.6 million increase in General Government expenditures represents an 11.4% increase, the largest components of which consist of increases in the Facilities & Operations and Information Technology departments of \$2.6 million and \$.9 million, respectively. The increase in Facilities and Operations is due largely to increases in utility costs and building repairs and maintenance of \$.8 million and \$1.0 million, respectively. The increase in building repairs and maintenance is a result of an increase in charge-backs made to other County departments. These charges are offset by a corresponding increase in revenue in the Facilities and Operations department. Approximately one-half of the increase in the Information Technology department is attributable to an increase in software maintenance agreements related to new systems that were implemented in 2005.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

The \$4.7 million increase in Public Safety expenditures represents a 9.2% increase, which is a result of increases in salaries and fringe benefit costs at the Sheriff Department, including the positions added during the year in connection with the contracts with the City of Mount Clemens.

Revenue Sharing Reserve Fund - The Revenue Sharing Reserve Fund reported property tax revenue of \$37.7 million in fiscal 2005, of which \$14.1 million was subsequently transferred to the General Fund, resulting in a surplus of \$24.1 million for the year ended December 31, 2005. The fund balance is restricted in its entirety and was \$52.8 million at year-end.

The fund balances of the County's nonmajor governmental funds were approximately \$70.1 million at year-end, an increase of approximately \$6.2 million over the prior year. Of the \$70.1 million, \$40.5 million is reported in the capital projects funds, all of which is designated or restricted for use in the construction, remodeling, renovation and maintenance of new or existing facilities.

GENERAL FUND BUDGETARY HIGHLIGHTS

The budget for each fiscal year is adopted by the Board of Commissioners in December of the prior year and may be amended from time to time throughout the year to reflect changing operational demands.

A comparison of budgeted and actual revenues is presented below.

Source	General Fund Revenue Budget and Actual By Source			
	Budget		Actual	Variance
	Adopted	Final		
Taxes	\$ 116,743,661	\$ 116,743,661	\$ 115,340,337	\$ (1,403,324)
Licenses and permits	392,000	392,000	391,395	(605)
Federal and State grants	18,314,760	7,994,860	8,421,712	426,852
Charges for services	23,925,970	26,474,362	30,297,038	3,822,676
Investment income	3,191,000	3,191,000	4,703,646	1,512,646
Admin charges to other funds	9,997,108	10,229,081	11,087,868	858,787
Fines and forfeitures	904,050	938,465	1,045,629	107,164
Other revenue	23,450	23,450	166,929	143,479
Transfers from other funds	8,655,000	19,155,000	22,724,515	3,569,515
	<u>\$ 182,146,999</u>	<u>\$ 185,141,879</u>	<u>\$ 194,179,069</u>	<u>\$ 9,037,190</u>

The original and final revenue budgets of the General Fund for fiscal 2005 were \$182.1 million and \$185.1 million respectively, an increase of \$3.0 million of final over originally adopted. Approximately \$1.2 million of the increase resulted from the new Sheriff contracts with the City of Mount Clemens. The budget for Federal and State grants was also decreased by \$10.5 and reclassified as "Transfer from Other Funds" to account for the transfer from the Revenue Sharing Reserve Fund as required by Public Act 357.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

Charges for Services revenues exceeded budget by \$3.8 million, consisting primarily of recording fees, which exceeded budget by approximately \$1.5 million, and Personal Services, which exceeded budget by roughly \$1.2 million.

Investment revenue was approximately \$1.5 million over budget as a result of higher than expected market interest rates.

The \$3.6 million favorable variance in the Transfers from Other Funds category was due to contributions from the Revenue Sharing Reserve Fund exceeding budget. The budget for the transfer from the Revenue Sharing Reserve Fund was maintained at that same level as was budgeted for State Revenue Sharing payments in prior years, thereby resulting in actual exceeding budget.

A comparison of budgeted and actual expenditures is presented below.

General Fund Expenditures Budget and Actual By Level of Control

Level of Control	Budget		Actual	Variance
	Adopted	Final		
Salaries and fringe benefits	\$ 106,880,835	\$ 111,301,306	\$ 106,759,993	\$ 4,541,313
Operating	40,150,173	39,715,737	35,217,551	4,498,186
Capital outlay - departmental	251,700	318,416	190,335	128,081
Capital outlay - nondepartmental	1,050,000	1,067,770	802,454	265,316
Transfers to other funds	69,683,555	70,107,354	60,347,238	9,760,116
	<u>\$ 218,016,263</u>	<u>\$ 222,510,583</u>	<u>\$ 203,317,571</u>	<u>\$ 19,193,012</u>

The original and final expenditure budgets of the General Fund for fiscal 2005 were \$218.0 million and \$222.5 million, respectively, an increase of \$4.5 million of final over originally adopted. Approximately \$4.4 million was in the area of salaries and fringe benefits, of which \$1.1 million relates to Sheriff Department personnel added during the year in connection with the contracts with the City of Mount Clemens for law enforcement and dispatching services. Another \$1.4 million increase relates to adjustments in fringe benefit budgets related to employee health care that were necessary because actual costs exceeded original estimates and another \$1.2 million was made in the Facilities and Operations department in conjunction with the increase in revenues discussed previously.

Actual General Fund expenditures were approximately \$19.2 million below budget. Of the total, \$4.5 million was in the area of salaries and fringe benefits, which can be attributed to vacant positions, employees not yet at their maximum salaries.

The final budget includes \$70.1 million in transfers to other funds. Actual transfers were approximately \$60.3 million, resulting in a favorable variance of \$9.8 million. Budgeted transfers are maintained at conservative levels due to the uncertainty of outside revenue sources.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

In summary, General Fund expenditures exceeded revenues by \$9.1 million for the year ended December 31, 2005. Unreserved fund balance was \$53.3 million or 12.0% of the total 2006 County operating budget.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets. The County categorizes its capital assets as follows: land, land improvements, buildings and improvements, machinery, equipment and vehicles and construction in progress. The County's investment in capital assets, net of accumulated depreciation, was \$166.5 million for governmental activities and \$6.7 million for business-type activities.

Macomb County's Capital Assets
(net of accumulated depreciation)

	Governmental Activities		Business-type Activities		Total	
	2004	2005	2004	2005	2004	2005
Land	\$ 9,233,484	\$ 12,543,652	\$ -	\$ -	\$ 9,233,484	\$ 12,543,652
Land improvements	2,761,707	4,626,135	108,408	212,237	2,870,115	4,838,372
Buildings and improvements	116,026,766	118,583,388	1,941,386	2,584,704	117,968,152	121,168,092
Machinery, equipment and vehicles	16,039,387	16,066,106	413,445	391,157	16,452,832	16,457,263
Construction in progress	13,475,219	14,642,374	93,259	3,556,554	13,568,478	18,198,928
	<u>\$ 157,536,563</u>	<u>\$ 166,461,655</u>	<u>\$ 2,556,498</u>	<u>\$ 6,744,652</u>	<u>\$ 160,093,061</u>	<u>\$ 173,206,307</u>

Major capital asset activity during the year included the following:

- Construction continued on the addition and renovation project at the Martha T. Berry Medical Care Facility. Approximately \$2.1 million was expended in 2005. The project is scheduled for final completion in 2006.
- The County purchased three parcels of land in the City of Mount Clemens for approximately \$2.8 million for future use.

Additional information regarding the County's capital assets can be found in the Note 3 to the basic financial statements.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

Long-term debt. The County's long-term debt was \$88.8 million at December 31, 2005, all of which related to governmental activities. All outstanding obligations are backed by the full faith and credit of the County. The components of the total liability are presented below.

Macomb County's Long-Term Debt - Governmental Activities

	<u>Balance Beginning of Year</u>	<u>New Debt Issued</u>	<u>Debt Retired</u>	<u>Balance End of Year</u>
General obligation bonds	\$ 72,750,000	\$ 22,255,000	\$ 6,235,000	\$ 88,770,000

The total debt of the primary government increased by \$16.0 million during the year, consisting of two new issues totaling \$22.2 million and \$6.2 million of debt retired.

The County issued \$19.4 million of general obligation bonds in December 2005, consisting of \$13.5 million for the purpose of constructing a high frequency emergency radio communications system and \$5.9 million for the purpose of constructing a District Court facility in the City of New Baltimore. The County also issued \$2.9 million of refunding bonds in December 2005 to advance refund \$2.7 million of bonds issued in prior years. The advance refunding will result in long-term interest savings of approximately \$.1 million.

The general obligation bonds of the County are rated **Aaa** by Moody's Investor Service and **AAA** by Standard & Poors, the highest rating awarded by each agency.

State statute limits the total amount of general obligation debt of the County to 10% of the assessed value of all property in the County. Assessed value is generally 50% of true market value. Management, however, believes that the taxable value of all property in the County is a more practical and conservative base on which to base the calculation of the County's debt limit. The assessed and taxable values of all property in the County as of December 31, 2005 was \$35.6 billion and \$28.6 billion, respectively. Therefore, the County's debt limitation was \$2.86 billion at year-end. The County's outstanding debt at December 31, 2005 of \$88.8 million was well below the limit based on either assessed or taxable value.

Additional information regarding the long-term obligations of the County may be found in the Note 4 to the basic financial statements.

MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The following factors were considered when developing the 2006 budget:

- The General Fund experienced a deficit of \$9.1 million in fiscal 2005, following a deficit of \$2.8 million in fiscal 2004. Legacy costs associated with employee health care and pension obligations continue to present the largest challenge to balancing the County budget. Health care costs have increased at double digit rates for the past several years and this trend is expected to continue into the foreseeable future. A 10% increase was budgeted for 2006. In addition, new pension benefits and stock market declines over the past several years have significantly increased the County's funding requirement to its defined benefit pension plan in each of the past three years. This trend is also expected to continue for the next several years as the required employer contribution moves closer to normal cost. In order to address the deficit, the Board of Commissioners requested all departments to cut their 2006 budgets by 3%, which is expected to result in savings of \$5.8 million. The County also negotiated health care concessions with its employee unions that are expected to reduce health care costs by \$2.5 million a year beginning in 2006. In addition, the Board of Commissioners will be performing an extensive review of discretionary programs in 2006 to determine if further budgetary savings can be realized by eliminating or reducing expenditures on programs that are not required by State statute.
- Salaries will increase 2.5 % in 2006 in accordance with collective bargaining agreements.
- Property tax revenues are expected to increase 5.5% in 2006.
- Market interest rates are expected to improve slightly during 2006. However, higher rates are also expected to result in a reduction in recording fees collected through mortgage refinancings.
- The advent of GASB Statements No. 43 and 45 related to postemployment health care benefits will require the County to disclose its funding progress relative to its Retiree Health Care Fund beginning in 2006. The County has been very proactive in recognizing its liability for retiree health care and began designating funds for this purpose in 1994. The County has contributed approximately \$68.0 million toward the unfunded liability since 1994. Investment earnings have increased the fund balance of the Retiree Health Care Fund to \$89.7 million as of December 31, 2005.
- Inflationary trends in the region compare favorably to national indices.
- Although the County is facing significant budgetary challenges at this time, its financial condition remains strong as demonstrated by the financial statements and other schedules included in this report.

**MACOMB COUNTY, MICHIGAN
Management's Discussion and Analysis
Required Supplemental Information**

CONTACTING THE COUNTY FINANCE DEPARTMENT

This financial report is designed to provide the citizens, taxpayers, investors, creditors and others with a general overview of the finances of the County. Questions concerning any information contained in this report or requests for additional information should be addressed to the attention of the Finance Director at the following address: Macomb County Finance Department, 12th Floor County Building, Mt. Clemens, MI. 48043. Requests can also be made by phone at 586-469-5250.