# MONTGOMERY COUNTY
# MARYLAND

## *Comprehensive Annual Financial Report*

*Fiscal Year 2001*

**July 1, 2000 - June 30, 2001**
**Rockville, Maryland**

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Montgomery County, Maryland

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2000

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

Anne Spray Kinney
President

Jeffrey L. Esser
Executive Director

# MONTGOMERY COUNTY
# MARYLAND

## *Comprehensive Annual Financial Report*

**Prepared by the**
**DEPARTMENT OF FINANCE**

**Timothy L. Firestine, Director**
**101 Monroe Street**
**Rockville, Maryland 20850**
**240-777-8860**

**Fiscal Year 2001**
**July 1, 2000 - June 30, 2001**

Montgomery County

# Vision Statement

*"Helping to make Montgomery County the best place to be through efficient, effective and responsive government that delivers quality services."*

## Guiding Principles

***We Will Provide Excellence in Government By:***

- Insisting upon customer satisfaction
- Ensuring high value for tax dollars
- Adhering to the highest ethical standards
- Appreciating diversity
- Being open, accessible and responsive
- Empowering and supporting employees
- Striving for continuous improvement
- Working together as a team
- Being accountable

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# INTRODUCTORY SECTION

DEPARTMENT OF FINANCE

Douglas M. Duncan
*County Executive*

Timothy L. Firestine
*Director*

November 30, 2001

Honorable County Executive,
Members of the Montgomery County Council, and
Chief Administrative Officer

Ladies and Gentlemen:

I am pleased to present the Comprehensive Annual Financial Report of Montgomery County, Maryland (the County), for the fiscal year-ended June 30, 2001. This report was prepared by the County's Department of Finance in cooperation with the finance departments of the County's component unit and joint venture organizations.

This report has been prepared pursuant to the provisions of Article 2, Section 214 of the Charter of Montgomery County, Maryland and includes the independent auditors' opinion, issued by the County Council appointed independent public accounting firm, as provided by Article 3, Section 315 of the County Charter. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation including all disclosures rests with Montgomery County, Maryland. We believe the data, as presented, is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the County as measured by the financial activity of its various funds and account groups; and that all disclosures necessary to enable the reader to gain the maximum understanding of the County's financial affairs have been included.

The accompanying report consists of four sections: introductory, financial, statistical, and index. The introductory section includes this transmittal letter, a list of principal officials, a copy of our Certificate of Achievement for Excellence in Financial Reporting awarded for the FY2000 report, a list of special acknowledgments, and the Montgomery County, Maryland organization chart. The financial section includes the general purpose financial statements and the combining, individual fund, and individual account group financial statements and schedules, as well as the report of the independent auditors. The statistical section includes selected financial and demographic information, generally presented on a multi-year basis. The index is presented solely to facilitate the identification of the individual funds, account groups, and component units of the County.

## THE REPORTING ENTITY AND ITS SERVICES

For financial reporting purposes, the County's reporting entity consists of: (1) the primary government, and (2) component unit organizations for which the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The funds and account groups of all agencies, boards, commissions, and authorities that have been identified as the primary government or a component unit have been included.

Section 2100 of the Governmental Accounting Standards Board (GASB) *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) describes the criteria for determining which organizations should be considered part of the County for financial reporting purposes. The basic criteria include appointing a voting majority of an organization's governing body, as well as the County's ability to impose its will on that organization, or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the County.

Office of the Director
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Based on an evaluation of this criteria, the following organizations are included as component units in the accompanying financial statements: Montgomery County Public Schools (MCPS), Montgomery Community College (MCC), Montgomery County Revenue Authority (MCRA), Housing Opportunities Commission of Montgomery County (HOC), and Bethesda Urban Partnership, Inc. (BUPI).

The County's participation in the following joint ventures is also disclosed in the Notes to the Financial Statements (see Note 14): Maryland-National Capital Park and Planning Commission, Washington Suburban Sanitary Commission, Washington Suburban Transit Commission, Washington Metropolitan Area Transit Authority, Metropolitan Washington Council of Governments, and Northeast Maryland Waste Disposal Authority.

Copies of the respective independently audited annual financial reports required by State or County law are available from the above mentioned component units and joint ventures.

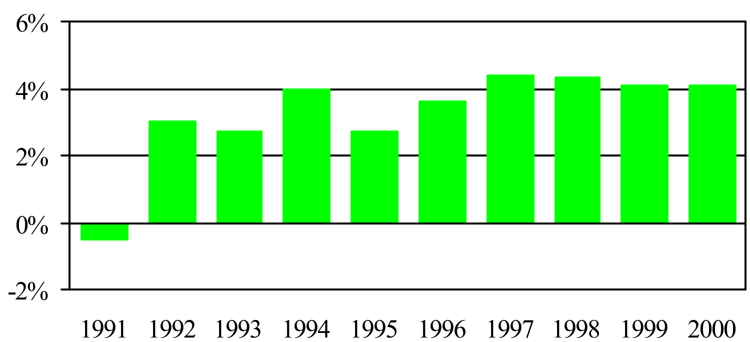
The County provides a wide range of governmental services as contemplated by statute and/or charter. These include: education, public safety, public works and transportation, culture and recreation, health and human services, community development and housing, environment, and general government services.

## ECONOMIC CONDITION AND OUTLOOK

### Summary of the Local Economy

Even though the national economy in fiscal year 2001 continued to expand, growth decelerated significantly from robust to flat during this period. This is in sharp contrast to previous years, when the economy, measured by gross domestic product (GDP), grew well over 4 percent. Growth was particularly strong in the latter part of this record-long ten-year expansion. However, an unanticipated drop in demand resulted in a substantial inventory build up following monetary tightening in response to rising concerns with inflation from excessive economic growth and stock market created wealth. Despite a reversal in monetary policy in the second half of fiscal year 2001, from aggressive tightening to aggressive easing, economic growth dwindled to just 0.3 percent in the final quarter of the fiscal year.

**REAL GROSS DOMESTIC PRODUCT (annual percent change)**



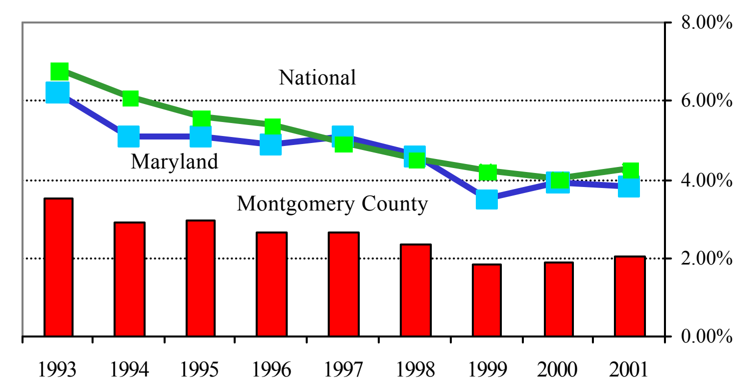

Source: U.S. Department of Commerce, Bureau of Economic Analysis

While the manufacturing sector was the first to experience a drop in activity to recession-lows, the economic slump soon spread to high-technology industries. In the face of declining corporate profits, overvalued shares trading at the domestic stock markets went into a free fall that lasted the entire fiscal year. Not even six consecutive interest rate cuts, bringing the federal funds rate down from 6.50% to 3.75%, were sufficient to stimulate economic growth and reverse the stock market sell off. When the economic slow down spread to other sectors of the national economy, both business and consumer confidence weakened, and global economic conditions worsened.

The regional economy remained fairly stable during the fiscal year, and did not experience the dramatic changes observed nationally. While the Washington region, and the County in particular, is not insulated from the national economic trend, there are several factors that contribute to dampening the impact of a national slow down. Foremost are the large presence of the federal government, both in terms of employment and procurement spending, and the absence of large manufacturing and computer high-technology bases. These factors tend to reduce the volatility in economic cycles and contribute to a stable business environment – i.e., neither high peaks nor deep valleys. Based on recent data, the County's economy in fiscal year 2001 slowed to a "soft-landing" scenario in contrast to the "hard-landing" scenario for the national economy. In general, economic growth in the County was broad based with a robust expansion in both residential and commercial sectors.

As the County recovered from the 1990-92 recession, employment conditions improved during the past decade. Following job losses in 1990 and 1991, the number of new jobs in the subsequent period measured through 1996 improved, on average, only 1 percent annually. In fact, it wasn't until 1996 that the County's job base had fully recovered from the 1990 recession when the total number of jobs finally surpassed the 1989 level. Moreover, following the last recession the federal government initiated its employment reduction program, resulting in the County losing close to 7,000 federal jobs – a 15 percent decline between 1992 and 1998. In contrast to the slow growth of the period 1991-96, job growth in the subsequent period, measured through 2000, accelerated to a 4 percent growth rate, and well above that observed statewide. In fact, private sector job growth in 2000 jumped 5.7% in the County adding 20,000 new jobs to the County's payroll. This constitutes 39% of private sector jobs created statewide, and is even more impressive considering that the County's share of all private sector jobs in Maryland was 19% last year. Clearly, the County has been the "engine of job growth" for the State in the past few years.

**UNEMPLOYMENT RATES**




Source: State of Maryland Department of Labor, Licensing and Regulation

The total number of jobs in the County last year was just under 448,000 of which the private sector share was 83% or 370,000 jobs. Between 1991 and 2000, close to 80,000 new jobs were added to the base, of which almost three quarters occurred in the last four years alone. Newly created jobs in the County reflect a continued transition to service-related industries – a sector that includes business, medical, architectural, and legal services – with 3 out of 4 new private sector jobs created between 1991 and 2000 in this sector. In fact, half of all private sector jobs in the County are now in services. The second largest category is retail trade where 20 percent of all private sector workers are employed. Reflecting a rebound in construction last year, employment in that sector jumped more than 11 percent – the strongest of all sectors. As a result of significant federal job cut backs, the government sector share of total employment fell to its lowest level, with the federal government employing less than 9 percent of all workers. As an employer, however, the federal government remains the largest in the County.

The strong employment growth tightened the County's labor market, bringing unemployment to a record-low. The unemployment rate in 2000 was 1.9 percent, while December 2000 recorded only 1.5 percent representing less than 7,300 unemployed individuals in the County. Even though unemployment remains low, it picked up slightly towards the end of fiscal year 2001, with an unemployment rate of 2.1 percent in June 2001 or 10,800 unemployed workers. By comparison with other jurisdictions in Maryland, the County consistently has the lowest unemployment rate, which was well below the statewide average (3.9 percent) and nationwide average (4.0 percent) last year.

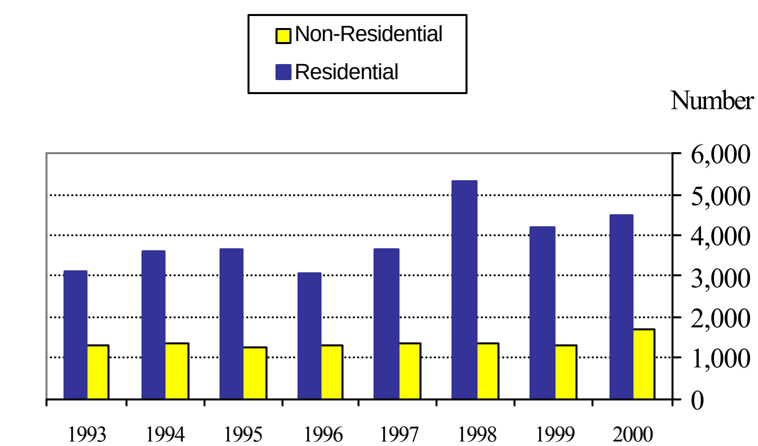
Measured by the total value of new construction, the County's construction industry in 2000 experienced a decline compared to the prior year. However, since construction in 1999 recorded close to a record $1.5 billion, the aggregate 26 percent decline last year nevertheless places 2000 as the second highest level of construction activity since 1987. The 49 percent decline in the non-residential sector in 2000 was due to the absence of several very large projects, related to hospitals and schools, which had pushed activity to record levels in 1999. In 2000, the non-residential sector added just over $520 million to the County's property base, with the vast majority in the commercial (45 percent) and education (40 percent) categories.

By contrast, the residential sector ended the year with a strong record with valuations close to $550 million – a 29 percent increase. In fact, since the increase for single-family houses was 41 percent last year, aggregate growth for the entire residential sector would have been greater if it hadn't been for significant declines in two-family houses and apartment buildings. Undoubtedly, the strong job market in the County combined with significant declines in mortgage interest rates boosted new home sales, and residential additions and major alteration projects.

Construction, again measured by value, for the second half of fiscal year 2001 shows that activity was virtually flat compared to the same six-month period of January – June 2000. In this latest period, the non-residential sector recorded a 9 percent gain primarily due to a 54 percent jump in education buildings and a 42 percent jump in new office construction reflecting increased demand for new class-A office space as the office vacancy rate declined to near-record low levels over the past few years. There was some moderation in the residential sector, with construction in the first six months of 2001 falling 4 percent below the same period last year.

Compared to other jurisdictions, construction in the County in 2000 was equally strong. With a total of close to 4,500 residential building permits, representing 7 percent growth, the County outperformed Maryland (-1 percent) and the nation (-5 percent). Even though the number of residential building permits issued in the County through June 2001 is the same as last year's six-month period, the State and the nation grew 3 percent and 4 percent, respectively. In general, the moderation in new construction, both residential and non-residential, in the most recent period, suggests rising concern with the national and regional economic outlook.

**RESIDENTIAL AND NON-RESIDENTIAL BUILDING PERMITS MONTGOMERY COUNTY**

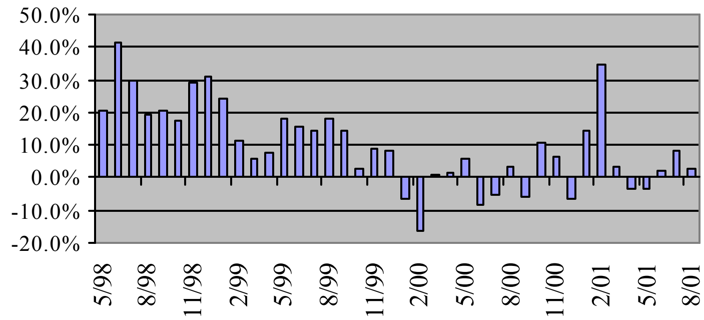



Source: Montgomery County Department of Permitting Services

The County's real estate market experienced a dramatic improvement at the onset of fiscal year 1998. This followed an extended period of lackluster sales growth in both residential and commercial sectors. Buoyed by a tight labor market, solid wage gains, low financing costs, and strong stock market gains, residential and commercial properties were purchased at a record pace. The strong trend in residential sales continued in fiscal year 1999, when the number of properties sold jumped 20 percent, on top of a 15 percent jump in the prior fiscal year. Even though the real estate market remained strong, the downward growth trend continued in fiscal year 2000 with total residential sales growing 7.5 percent, and actually declining 4.5 percent in fiscal year 2001. However, even with the modest decline in fiscal year 2001, the level of sales was the second highest in the past decade.

Sales of existing homes have been particularly strong in the County. Measured on a calendar year basis, existing home sales jumped 26.4 percent in 1998 and 12.5 percent in 1999, but remained flat (0.4 percent) in 2000. Much of the moderation in this trend, however, was due to a lack of supply – not demand. This is reflected in the sharp jump in average house prices, which jumped 6.6 percent in fiscal year 2001 – a decade-high. The sales trend reversed itself in the first six months of 2001 with a 4.5 percent growth rate in the County – well above the 2.5 percent growth rate observed nationally during that period. The lack of inventory remains an obstacle and has kept growth rates well below those seen just a few years ago. Additional factors that contributed to the recent slower growth are modest growth in household formation, weaker consumer confidence, significant decline in stock market created wealth, and a modest rise in unemployment.

**HOUSING SALES**
**PERCENT CHANGE YEAR-OVER-YEAR**
**MONTGOMERY COUNTY**




Source: Metropolitan Regional Information Systems, Inc.

Similar to the residential real estate market, commercial property sales jumped in fiscal year 1998. The commercial market jump, however, was far more significant that year, reflecting a more than doubling in the total transaction amount (109 percent) and an 18 percent jump in the number of commercial transactions. However, even though the number of commercial sales was up another 7 percent in fiscal year 1999, the total value of commercial properties sold dropped 29 percent in fiscal year 1999. Despite the strong economy, the commercial market did not rebound, and both sales amount (-2 percent) and number of sales (-17 percent) declined in fiscal year 2000. As the economy continued to weaken during fiscal year 2001, the downward slide in the commercial real estate market accelerated with a 30 percent drop in the amount and a 9 percent drop in the number of transactions. Despite the significant declines in the past three fiscal years, the commercial real estate market, in terms of amount of transactions, remains well above levels observed during and immediately following the last recession. One contributing factor was the substantial drop in interest rates, at least partially offsetting weaker demand for commercial sales resulting from deteriorating economic conditions.

Robust consumer spending in the County extended to retail sales as well. In fact, retail sales, measured by sales tax receipts, in 2000 recorded the biggest jump in the past six years. However, even though retail sales grew 6.6 percent in 2000, they were below growth rates observed statewide (8.2 percent) and nationwide (7.6 percent). The County sales trend in 2000 reflected particular strength in automotive (27 percent) and hardware & machinery (31 percent), weakness in apparel (2 percent), but declines in general merchandise (-0.2 percent) and building equipment (-1 percent). On the other hand, the sales trend for Maryland for the same year reflected a more even distribution among the various categories, with neither high outliers nor declines. In fact, the 7 percent growth in building equipment sold statewide is in sharp contrast to the 1 percent decline in the County, especially considering the robust construction market.

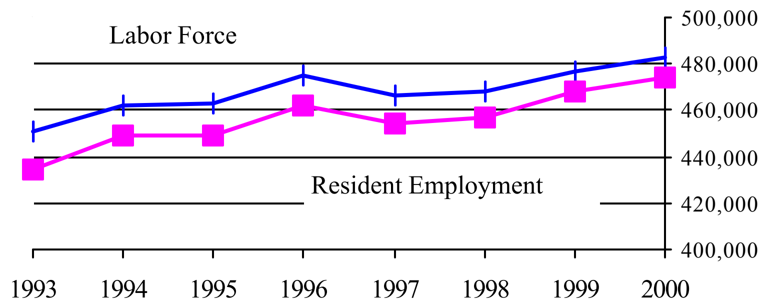
Retail sales recorded in the first six months of 2001 show a reversal of the trend in favor of Montgomery County, with sales in the County up 6.4 percent, compared to 4.8 percent statewide, and only 3.1 percent growth nationwide. As a result of stronger sales in the second half of fiscal year 2001, retail sales in the County jumped 7.4 percent compared to 6.1 percent in Maryland in fiscal year 2001. On the other hand, due to the significant discrepancies between the various sectors the County's growth is less balanced than the statewide trend and hence more volatile.

Federal procurement spending is related to outsourcing by the federal government to private sector industries. In a continued effort to reduce its operating costs, the federal government, during the decade of the 1990s, accelerated its efforts to increase outsourcing (privatizing) of many of its functions, while reducing its employment base. Since such procurements represent a large investment in the economy's private sector, it is important to our local economy. In fact, procurement spending, which reached a record $3.8 billion in federal fiscal year 2000, equates to approximately 10 percent of the County's total economic activity. The County's share of the total amount of procurement spending in the Washington MSA is 13 percent – a share that has been shrinking consistently since the mid-1980s when the share was 22 percent. Most of the growth in the past decade within the Washington MSA occurred in Northern Virginia jurisdictions due to a greater concentration of defense-related and high-technology industries most of which are located close to the Pentagon. Following a 1.5 percent decline in procurement spending in the County in 1999, spending jumped 10 percent last year.

**Industries Affecting the Local Economy**

Montgomery County is the second largest suburban employment center in the greater Washington region, with a resident employment base of 473,902 in 2000. The County's private sector represents 83 percent of the County's total employment base, with the remaining 17 percent distributed primarily between federal (51 percent) and local (48 percent) governments. The County's private sector includes the following industrial categories: services (50 percent), retail trade (20 percent), finance (9 percent), construction (7 percent), manufacturing (5 percent), wholesale trade (4 percent), transportation (4 percent), and miscellaneous (1 percent). Over time, the County's job base is becoming less dependent on government and more on the private sector, as illustrated by a steady decline in the government share from 29 percent twenty years ago to the current 17 percent share. Despite the shrinking share of the government sector, the federal government is the third largest industrial sector and the largest single employer in the County. The fourth largest industrial sector is local government - county and municipal – which employs 8 percent of the total job base and a share that decreased steadily from 11 percent some twenty years ago.

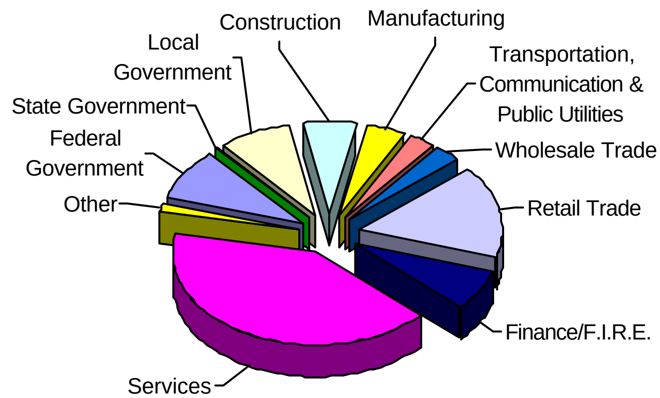
**MONTGOMERY COUNTY LABOR FORCE AND RESIDENT EMPLOYMENT**




Source: State of Maryland Dept of Labor, Licensing and Regulation

Following six consecutive annual declines between 1992 and 1998, in which close to 7,000 jobs were lost, the number of federal government jobs expanded modestly in both 1999 (0.7 percent) and 2000 (1.4 percent). Montgomery County is home to 23 federal agencies in which nearly 60,000 civilians are employed, including a significant number of non-Federal employees working as consultants or researchers. In addition to the federal agencies, there are a number of prestigious research facilities such as the National Institutes of Health in Bethesda, the National Oceanic and Atmospheric Administration in Silver Spring, and the National Institute of Standards and Technology in Germantown. Federal agencies include the Department of Health and Human Services (28,400 employees), the Department of Defense (14,500), the Department of Commerce (7,300), the Nuclear Regulatory Commission (2,200), and the Department of Energy (1,500). These five agencies, combined, employ 97 percent of all federal civilian employees in the County.

**ALLOCATION OF JOBS**
**BY SECTOR**
**Montgomery County**



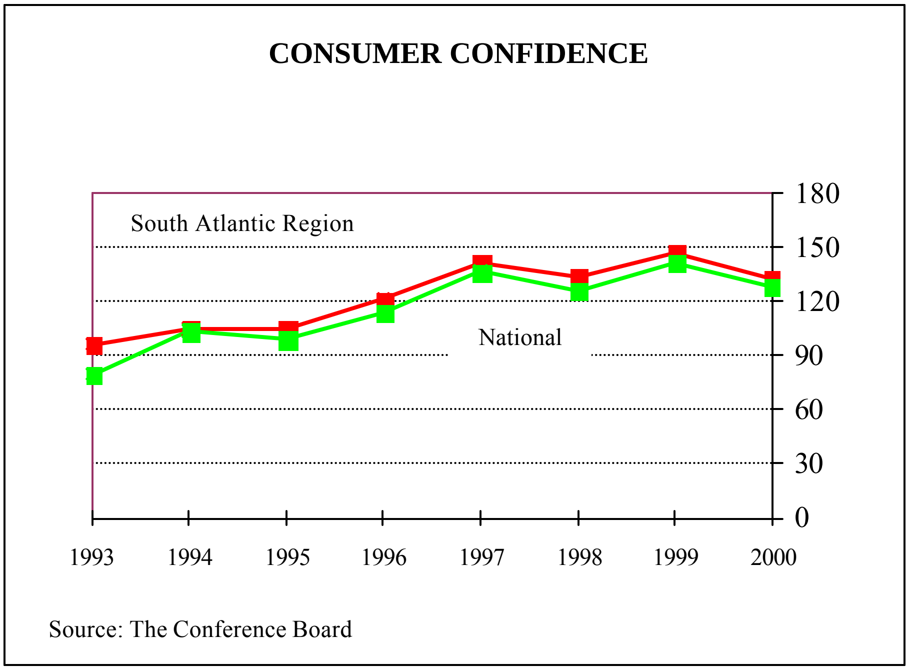

Source: Maryland Department of Labor, Licensing and Regulation "Employment and Payrolls"

There are also several thousand private sector employers in the County, including Adventist Healthcare (6,000), Giant Food Corp. (4,700), Chevy Chase Bank (4,500), Verizon (4,400), Marriott International Inc. (3,500), Hughes Network Systems (3,200), Comsat Corp./Lockheed Martin (3,100), and IBM (3,000 employees). The County actively supports the high-technology industries, including a high-technology business incubator program at the Shady Grove Life Sciences Center. High-technology industries employ close to 50,000 workers, representing 14.3 percent of all private sector jobs in the County and 32.4 percent of all such jobs in Maryland – by far the largest concentration of such jobs and firms statewide. Growth in high-technology jobs in 1999 – the last year for which data are available – was 2,770 (5.9 percent) representing the highest gain in number of such new jobs in Maryland. Montgomery County has the largest concentration of Maryland's high-technology employment in computer & data processing services, engineering services, commercial physical research, and biological research organizations, with a significant number of such firms located along the I-270 Technology Corridor.

**Future Economic Outlook**

Following a year with significantly reduced economic growth and ending fiscal year 2001 with virtually no growth, the outlook was for a very modest pick-up in the middle of fiscal year 2002. Even though the business sector performs well below par, consumers continued to spend. Since roughly two-thirds of economic growth depends on consumer spending, even with lower spending growth rates, consumer spending was expected to partially offset the reductions in GDP from weak business capital spending and inventory depletions. As a result, the economy was projected to expand modestly towards the end of this year or first quarter of 2002.

Despite the generally weak economic data, especially related to manufacturing and high-technology industries, consumer confidence, and retail sales, residential new construction and the real estate market held up remarkably well. Moreover, inflation edged down again following a temporary spike in energy prices, while continued productivity growth further assisted in keeping inflation in check. The Federal Reserve Board aggressively cut interest rates in order to stimulate economic growth and rebound the ailing stock markets. At the same time, the federal tax cut would provide fiscal stimulus in the fall of 2000. The most recent data indicate that both the economy and stock markets, after significant declines, were approaching a "bottom."




All of that changed on September 11, 2001 when terrorists highjacked four airliners and destroyed the twin towers of the New York City World Trade Center, and badly damaged the Pentagon near Washington DC. In addition to the horrific loss of life and collateral damage, the economic and financial impact was tremendous. The stock markets on Wall Street remained closed for an unprecedented four days, while major central banks around the globe cut interest rates and flooded the markets with cash. Following an initial and dramatic sell off when the stock markets reopened, investor sentiment improved, allowing the financial markets to stabilize. This also suggests that the concerted effort by financial institutions not only successfully avoided a major panic that could have pushed the markets into a free-fall, but also established sufficient investor confidence allowing for a modest rebound of all major indexes.

The economic fall out may last considerably longer. Due to continued threats of further terrorist attacks, airline travel has been severely curtailed, while flight operations at Reagan National airport are scheduled to remain below those prior to September 11th. Already reeling from severe cutbacks in business travel, the airline, hotel, restaurant, and tourism industries are in recession. Unemployment is picking up, which will further weaken consumer confidence, and push the already fragile national economy into a recession. The regional economy is unlikely to avoid the impact from the national recession, especially if business and tourism travel do not rebound. Additionally, the military action that began in FY02 has impacted economic sentiment. Unlike the 1991 "Gulf War" which temporarily weakened consumer confidence until the successful military actions created a rebound in consumer spending, this situation, according to government officials, will take much longer.

Prior to September 11th, the economic forecast for the national economy was a "hard-landing" scenario with close to zero growth at the onset of fiscal year 2002, followed by a modest pick-up as the year progresses. The economic forecast for the County was a "soft-landing" scenario with growth in the low to middle 2 percent range, with slightly stronger growth towards the end of fiscal year 2002. Even though the revised economic forecast reflects considerably slower growth, the County is well positioned to avoid the recession occurring in the national economy. Unlike the national economy, the County did not experience the fall out in economic activity and employment from the sharp decline in manufacturing and computer high-technology industries. Moreover, the federal government, through employment and procurement spending, has a stabilizing impact on the County's economy. While tourism and business travel are important, they do not constitute a major share of the County's economy. Moreover, the biotechnology industry, of which the County is one of the premier centers in the country, has remained strong throughout the recent economic slow down, and is expected to continue to boost the County's economy.

Clearly, much depends on how events unfold. A quick solution to the military conflict in Afghanistan and a sense of security regarding national airports and potential terrorist attacks may result in only a brief national recession and low, but positive, growth in the County. On the other hand, a further deterioration will push the national economy into a full-blown recession, while the regional and County economies are unlikely to avoid some recessionary impact. This includes weak retail sales, a sharp rise in unemployment, and deteriorating construction and real estate markets (both residential and commercial). Increased federal procurement spending may offset some of these negatives if the federal government increases defense spending without reprioritizing the current procurement spending program. Finally, the impact from fiscal stimulus – both tax refunds and lower tax rates – and monetary easing – federal funds rate from 6.5 percent down to 2.0 percent (with more cuts likely) – has not yet fully impacted the economy and will offset some of the underlying weakness in both national and County economies.

## MAJOR INITIATIVES

Major initiatives of the County, including certain initiatives of its component units, during FY01, presented by functional area, include the following:

### Community Development and Housing

Affordable Housing: The County finalized the first update of the County's Housing Policy in twenty years. The County's Housing Initiative Fund and related capital project made $11 million in loans and other expenditures, preserving and renovating 726 at-risk affordable housing units, and assisting with the creation of 189 new affordable housing units. A new Rehabilitation Program for Small Rental Properties was introduced to help owners of existing affordable small rental properties repair their properties and keep them in good shape. The County used the federal HOME program to make loans totaling $2.1 million for the creation of 120 affordable units, and the preservation and renovation of 109 units.

Business Retention and Development: The Economic Development Fund awarded $1.25 million to assist 11 companies committed to promoting growth and creating or retaining over 1,500 jobs in the County, and, over the next three years, should result in the creation of over 2,300 new jobs. Overall, the County assisted about 2,071 businesses, resulting in private capital investment of approximately $180 million in the County.

State Support for Economic Revitalization: The State budget included $5 million in funding to complete the State's $35 million commitment to downtown Silver Spring redevelopment. Construction of Phase I of this project is underway and will be completed later in 2001. Also in Silver Spring, $500,000 was included for the development of a business incubator for information technology start-up firms.

Wheaton Redevelopment: A study of downtown Wheaton redevelopment identified four scenarios, including Wheaton as a "Fixer Upper", an Entertainment District, an Urban Village, or an Office Town Center. The redevelopment scenarios may require County and State investment to provide public parking, infrastructure, relocation benefits to small businesses, streetscape improvements and creation of a major town green space. The exact combination of public improvements will depend on the type, size and location of private development projects.

Electronic Permitting ("E-Permitting") System: In FY01, a website was designed to interface with a new automated permitting system. The Department of Permitting Services website (http://permits.emontgomery.org) provides customers with direct access to real-time information as projects progress through the development process. The status of an application/permit, the reviews that are planned/in progress/completed, and inspection information is available through multiple access methods. The website provides information on every DPS business process, including permit requirements, fees, application procedures, how long the process will take, a process flowchart, and other useful information for the public. The E-Permitting initiative was awarded a 2001 Achievement Award from the National Association of Counties.

Agricultural Services: During the year, the County spent $2.2 million to preserve 625 acres of farmland for agricultural production through the Agricultural Easement Program. The County preserved another 872 acres of green space using $2.4 million from the State Rural Legacy Easements Program.

**Culture and Recreation**

Center for Cultural Diversity: Development of the Charles W. Gilchrist Center for Cultural Diversity progressed during FY01. The Center includes a New American welcome center, a language bank, and an array of other services designed to help our foreign-born residents, who now represent more than one quarter of all County households, according to the most recent census. The Center opened in September 2001.

Recreation Visual Tours: The Visual Tours program was developed by Recreation staff and e-Montgomery staff in the Department of Information Systems and Telecommunications to allow customers to virtually "tour" recreation facilities and obtain information about the facility. Customers can also map directions from their residence to the County facilities. The County received an award for the Visual Tour Program from the Maryland Recreation & Parks Association and recognition from the State of Maryland's House of Delegates.

**Education**

Montgomery College: Montgomery College established the Macklin Business Institute Center for Entrepreneurship (CFE). The CFE offers symposia, courses and business services focusing on entrepreneurship and venture capital topics. The College is also breaking ground for the first stage of its Takoma Park Campus expansion project, which will enable the campus to strengthen its health sciences programs. To meet the growing teacher shortage, the College is developing a new Associate of Arts in teaching degree. The College is implementing grants from the National Science Foundation, the National Institutes of Health, and the Department of Education to enhance student success in the sciences and humanities. The Chronicle of Higher Education has named Montgomery College to its top ten list in community college private fundraising.

Montgomery County Public Schools (MCPS) Service Efforts: During FY01, MCPS operated the nation's $19^{th}$ largest educational system, serving more than 134,000 students in pre-kindergarten through Grade 12 in 189 schools. For the first time, white students were not the statistical majority. The system served more than 3,000 additional students in FY01, with more than 76 percent of the operating budget devoted to instructional costs. The cost of education was approximately $49.50 per student per day. The operating budget of $1.2 billion and the capital budget of $136 million included $26 million for new initiatives to improve the quality of education. Over the past seven years, the County has increased the public school system budget by nearly 60 percent, while student enrollment has increased 17 percent.

MCPS Accomplishments and Accountability: MCPS achieved progress on achievement measures in the Maryland School Performance Program. Scores on the Comprehensive Test of Basic Skills administered to students in Grades 2, 4, and 6 are among the highest in Maryland and at or above the national average. Twenty-nine County public schools were named among the State's fastest improving schools. MCPS completed development of a new teacher evaluation system in partnership with the Montgomery County Education Association. The new system was implemented in 34 phase I schools in FY01. MCPS completed an extensive external audit of its mathematics curriculum, and began development of a new K-12 mathematics curriculum.

MCPS Class Size Reductions: The class size reduction initiative continued with $5 million in FY01, and a total of more than $23 million over four years. MCPS reduced the number of oversize classes in secondary schools, and this resulted in the lowest high school class size level in six years. MCPS began an initiative to expand the number of schools that offer full-day kindergarten, adding 8 schools, for a total of 17 schools. This initiative includes a reduction of class size in full-day kindergarten to a maximum of 15 students.

MCPS Federal and State Education Funding: The State's FY01 budget included $51.2 million for Montgomery County projects. FY01 State funds were used to construct additions and make other improvements to Wheaton, Blake, Walter Johnson, Northwest, Magruder, Watkins Mill, and Wootton High Schools. The funds were also used for renovations and improvements to 66 other schools in the County. In addition, the State budget included $180 million in direct aid for education programs, an increase of 10.9 percent from FY00. MCPS received more than $71 million in grants, an increase of 67 percent over three years. Among the grantors were the U. S. Department of Education, the National Science Foundation, and the Howard Hughes Medical Institute.

**Environment**

Stormwater Management: There are 3,200 stormwater control structures in the County that require annual inspection and maintenance. To ensure compliance with State and Federal law, County legislation was introduced that will establish a program for the maintenance of these structures, and a $500,000 study was conducted to identify impervious surface in the County, perform integrity inspections of conveyance systems, construct a rate structure, and provide support to a group process designed to deliberate policy implementation alternatives. In addition, approximately $400,000 was spent on facility inspection and record keeping requirements. Further action is pending Council action on the proposed legislation and a phased-in program to enhance stormwater management, with the ultimate goal of enhancing water quality in County streams.

**General Government**

East County Regional Services Center: The new East County Regional Services Center was largely completed in FY01. The new facility houses the East County Branch of Health and Human Services and the Montgomery County 3rd District Police Satellite Station. As a major government service facility for East County residents, the 15,000 square foot building has three public meeting rooms and a Community Assistance and Resource Library which is open to the public. The facility opened in August 2001, completing a six-year Capital Improvements Project for the eastern region of the County.

Liquor Control Activities: Installation of a new conveyor system in the beer warehouse was completed in mid-May at a cost of approximately $1 million dollars. The system has provided immediate gains in efficiencies in the areas of night loading, inventory control, and space management. The Department of Liquor Control was reorganized from four divisions into two divisions, Operations and Administration. This enabled the Department to eliminate duplicate efforts, streamline the operation, and focus on the core mission of delivering service to customers.

**Health and Human Services**

Early Childhood Initiative: Established in FY01, this program serves as the focal point in addressing the needs of all Montgomery County children from birth to age five. The program's goal is to assure that young children have the foundation to attain their full potential by the time they enter kindergarten by providing quality early care and nurturing, participation in appropriate programs, and demonstrated community commitment. It is a collaborative effort of private sector care providers, Montgomery County Public Schools, the Collaboration Council, several County departments, and other key interest groups.

Talk to Your Daughter About Violence Program: In Montgomery County, almost 80% of female victims of homicide and reported rapes were attacked by someone with whom they had a relationship. Half of all reported rape victims are between 11 and 20. Yet, most parents rarely discuss relationship violence with their children. The County launched a public education campaign distributing brochures and posters in English and Spanish to every County middle and high school. The brochure, *Talk to Your Daughter About Violence* and *What Every Girl Needs to Know About Violence* describes the problem, indicators for violence in relationships, how to help and where to find resources. Almost 10,000 brochures and 500 posters were distributed to parents, schools, doctors, service providers and community organizations.

**Public Safety**

Integrated Justice Information System: A working group developed a set of Integrated Justice Information System (IJIS) objectives to guide planning for justice information systems. The objectives include expanded system functionality; improved inter-agency communication; enhanced access to shared, timely, accurate and complete information; and reduced paper-based processing and redundant data.

Juvenile Assessment Center: This Center functions as a single point of entry for children, youth, and families that become involved in the juvenile justice system, including the substance abuse system. It houses staff from Juvenile Justice Services of the Department of Health and Human Services, the Youth Services Division of the Police Department, the Maryland Department of Juvenile Justice, and others to ensure a functional integration of screening, assessment, forensic evaluation, case tracking, and treatment services. Establishment of the Juvenile Assessment Center is a major step in implementing the County's comprehensive Juvenile Justice Plan.

Pedestrian Safety: The County launched aggressive efforts during FY01 to raise public awareness of pedestrian and traffic safety. With more pedestrian-related deaths than homicides last year, it was clear that the County needed to take a lead in reducing such tragedies. County Police began targeting areas where pedestrian safety is of particular concern by encouraging both jaywalkers and aggressive drivers to change their behavior.

State Support for Judicial, Public Safety, and Child Welfare Programs: The FY01 State budget contained $9.2 million in funding for new district courts in both Silver Spring and Rockville. This funding will be used for land acquisition and preliminary planning. The FY01 State budget contained $7.7 million in funding for the County's new correctional facility in Clarksburg, which is scheduled for opening in summer 2002. This completes the State's $31 million funding commitment for this facility. The State budget also provided $260,000 for an initiative to increase staff and improve facilities at the Noyes Children's Center, and $500,000 to help reduce caseloads for child welfare workers.

Emergency Communications System: The County significantly enhanced its emergency communications system during FY01 with development of a new 800 MHz radio system to serve Montgomery County Government, a mobile data radio system to serve the Police, Fire Rescue, and Sheriff departments, and a new Emergency Communications Center equipped with a computer aided dispatch system, records management system, and an automatic call director / E911 system. This system will provide considerably improved radio coverage throughout the County, access by Police/Fire Rescue and the Sheriff to data files without involving the dispatcher, significant records management capability, and automatic vehicle location capabilities to allow quick assignment of the closest response unit to manage public safety response units. The old Emergency Communications Center will be remodeled to serve as an alternate center to back up the new center.

**Public Works and Transportation**

Transit Services: In September of 2000, the County reduced the cost of passes on the County-operated Ride On bus service by 44 percent in order to increase the use of mass transit in Montgomery County. At the same time, Ride On bus service was increased by approximately 4 percent. The result was an increase of 1.1 million passengers from the previous year, or a total of 21.7 million passenger trips on Ride On for fiscal year 2001. A new trolley service in Bethesda is offering free, around-town transportation to further relieve traffic congestion.

## FINANCIAL INFORMATION

### Accounting System and Budgetary Control

The accompanying financial statements, schedules, and tables have been prepared on a fund basis using accounting policies that are in accordance with generally accepted accounting principles applicable to governmental units and higher education institutions as prescribed by GASB, the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA).

The accounting records for the general governmental operations and expendable trust funds are maintained on a modified accrual basis, with the revenues recorded when available and measurable, and expenditures recorded when the services or goods are received and the liabilities incurred. Accounting records for the proprietary fund types and similar trust funds are maintained on the accrual basis. Under this method, all revenues are recorded when earned and expenses are recorded at the time the liabilities are incurred, without regard to receipt or payment of cash. The Higher Education Fund type is also maintained on the accrual basis.

Encumbrance accounting is employed in the governmental and proprietary funds. Purchase orders, contracts, and other commitments for the expenditure of funds are recorded in order to reserve that portion of the appropriation. In the governmental funds, encumbrances are reported as a reservation of fund balance because they do not constitute expenditures or liabilities. In the proprietary funds, encumbrances are eliminated for financial statement presentation.

Budget control (maximum spending authority) is exercised by the Montgomery County Council over the primary government (Montgomery County) and certain component units (MCPS, MCC, MCRA, and HOC) by approving spending authority in a variety of categories. In addition, Montgomery County is the primary source of funding for BUPI, which provides services in the Bethesda Urban District on behalf of Montgomery County. Montgomery County provides appropriation authority within each fund in three categories: Personnel Costs, Operating, and Capital Outlay; MCPS and MCC are provided appropriations in categories compatible with promulgations by the State Boards of Education and Community Colleges. Capital projects of MCRA are approved by the County Council at the project level. The HOC operating budget is prepared on a project basis, and the County Council has authority to approve project budgets that include County funding. The County Council funds approximately 3 percent of HOC's operating budget.

### Internal Accounting Controls

In developing and managing the County's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable assurance regarding (1) the safeguarding of assets against loss from unauthorized use or disposition, and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. 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 evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that the County's internal accounting controls adequately safeguard assets and provide reasonable assurance for the proper recording of financial transactions and for reliance upon the financial records in the preparation of financial statements.

Montgomery County has three significant programs that enhance the internal controls of the government. First, the County maintains an internal auditing staff that reports to the Director of Finance. This staff performs periodic and regular financial and operational audits throughout the County's agencies and departments. The internal auditing effort has been bolstered by the use of contracts with public accounting firms. During the fiscal year-ended June 30, 2001, audits performed by contract with auditing firms covered fiscal operations and contract compliance. Second, the County Council maintains an office responsible for "Legislative Oversight" activities. Third, the Office of Inspector General is responsible to (1) review the effectiveness and efficiency of programs and operations of County government and independent County agencies, (2) prevent and detect fraud, waste, and abuse in government activities, and (3) propose ways to increase the legal, fiscal, and ethical accountability of County government departments and County-funded agencies.

Internal audit efforts are also employed by MCPS, whose internal audit staff reports to the Deputy Superintendent.

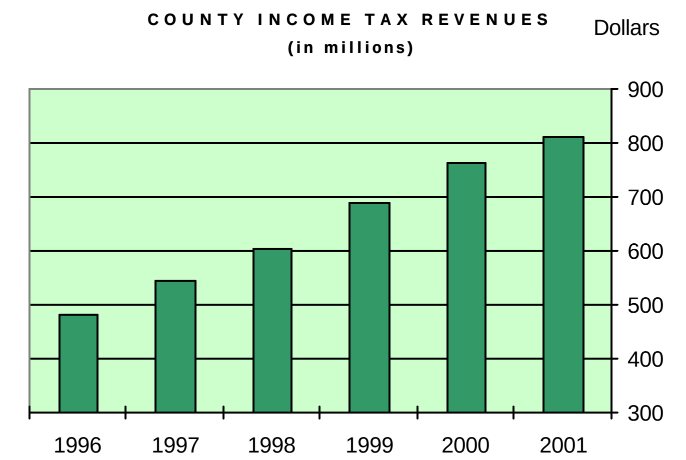
**General Governmental Functions**

*Revenues*

Montgomery County concluded the fiscal year ended June 30, 2001, with an undesignated General Fund balance of $59.3 million, a decrease of $16.1 million from the balance of the previous fiscal year. Total fund balance is $264.0 million at year-end. Due to higher than expected tax revenues, the Revenue Stabilization Fund (RSF) grew to $79.5 million – the maximum fund size for that fiscal year. Following the mandatory contribution requirement, half of actual General Fund receipts from the income tax, transfer and recordation taxes, and investment income above the budget estimate must be transferred to the RSF. With the exception of investment income, the remaining three revenue categories came in higher than expected. The income tax, however, was the primary source for the overall growth in the RSF. Due to the maximum fund size requirement, the mandatory contribution was limited to $8.9 million in FY01. There were no discretionary contributions made to the RSF in FY01, while, pursuant to the County Code, the $4.8 million interest earned in the RSF during the year was transferred to the Debt Service Fund.

General Fund revenues on a budgetary basis totaled $1,734.6 million and were 4.3 percent above the budget estimate for the year. Revenues reflect a 4.5 percent growth over the prior fiscal year. Compared to the budget estimate, the largest contributor to the revenue growth occurred in the tax category. In fact, collections from all taxes exceeded the budget estimate by $75.1 million (5.0 percent), representing 105 percent of the excess revenues for the year. The County income tax, fueled by a continued strong growth in employment and modest growth in tax liability from stock market trades, contributed the majority of the excess tax collections, as receipts came in $43.1 million (5.6 percent) higher than the budget estimate. The booming real estate market resulted in unanticipated growth in transfer and recordation tax receipts, with a combined $11.5 million (12.7 percent) excess revenue stream for the year. Higher than expected receipts from the combined income tax and real estate taxes, explain 76 percent of the variance between the budgeted General Fund revenues and actual receipts. Reflecting stronger than projected assessable base growth, the property tax collections came in 2.9 percent above the budget estimate. The continued strength of the regional economy contributed to better than expected revenues from the telephone (14.4 percent) and hotel/motel (16.6 percent) tax, while the fuel/energy tax came in close to the estimate (2.1 percent). By contrast, due to a correction by the State Comptroller for an overpayment made in the prior fiscal year, the admissions tax (-16.5 percent) came in well below the budget estimate for the year. Reflecting, in part, a 10 percent drop in portfolio balance, General Fund investment income came in $5.0 million below the budget estimate, contributing -7.0 percent to the total General Fund revenue variability in fiscal year 2001. All other categories came in close to the projected budget amounts with minor contributions to total General Fund variability. These categories include Fines and Forfeitures (1.9 percent), Charges for Services (0.8 percent), Miscellaneous (0.6 percent), Licenses and Permits (0.3 percent), and Intergovernmental (-1.3 percent). Moreover, in contrast to prior fiscal years, the variability between budgeted and actual amounts was considerably lower in FY01. For example, while the variance ranged between 8 and 9 percent in the three prior fiscal years, that variability declined to just 4 percent in FY01.

The County income tax received another boost from a rapidly expanding employment base and strong wage gains. By contrast, growth in capital gains income from stock market trades, as well as stock options, weakened considerably in FY01. The latter two categories had contributed significantly to the double-digit growth rates for the income tax in the prior four fiscal years and to the substantial variance between budgeted and actual amounts in those years. As a result of the significant drop in capital gains growth, revenues increased 6.7 percent in FY01 – the slowest increase since FY96. Because of Montgomery County's high concentration of wealthy taxpayers, the County receives a large share of non-wage income, amounting to roughly 30 percent of taxable income. This partly explains the strong growth, on average 12.2 percent between FY97 and FY00, when stock markets grew at an unprecedented rate, but also explains the sharp decline in growth when the same stock markets fell sharply during most of FY01.



Source: Montgomery County Department of Finance

Compensating for the weaker non-employment income conditions, employment and wage growth rebounded in the County in FY01. The number of jobs in the County jumped 4.9 percent in 2000, with 5.7 percent growth in private sector jobs – twice the growth rate in 1999. Combined with average wage growth of 5.8 percent, reflecting the tight labor market in the County, the expanding employment base was the primary source of growth in income tax receipts. As a result of income tax liability growth in non-wage and wage categories, both estimated payments and withholdings jumped 10 percent in calendar year 2000 – identical to the prior three years. Similar to the period FY97 through FY00, receipts again increased due to growth in late-filer collections from taxpayers who, in this case, underestimated their 1999 tax liability which the County otherwise would have received in FY00. However, in contrast to the prior five fiscal years, when receipts grew between 19 and 29 percent, last year's growth slowed to 5.7 percent. As a result of these trends, collections were $812.4 million, or $43.1 million above the original budget estimate. A mid-year revision for FY01 captured all of the increase, while subsequent data suggest that the estimate for the next fiscal year remains on track. In fact, the mid-year revision with 6.8 percent growth modestly overstated the actual growth rate of 6.7 percent. The projected recession for the national economy, and weaker outlook for the regional economy, suggest that the recent employment growth trend will slow. As labor market conditions soften, growth in average wages will decline. In addition, stock market gains are not expected to return to levels observed in the late nineties. As a result, growth in income tax receipts is projected to moderate to levels that are considerably lower than what was observed in the four fiscal years prior to FY01.

Property tax collections in the General Fund of $623.8 million exceeded the budget estimate by only 2.9 percent. The variance between the original budget forecast and final receipts is attributed to stronger than projected growth in the assessable base. Even though revenues from penalties & interest jumped significantly above their historical average, this was more than compensated for by an unexpected drop in revenues from prior tax years. Primarily due to significant growth in new construction and higher reassessment growth, the real property tax base grew 3.4 percent in FY01. New construction occurred mainly in the residential sector and reflected the sharpest jump in construction activity in the post-1990 recession period in Montgomery County. In addition, construction in the commercial sector increased to a nine-year high in FY01. Following a 3.6 percent decline in the personal property base (roughly 12 percent of the total base) in FY98, personal property expanded in subsequent fiscal years, growing 2.8 percent (FY99), 3.2 percent (FY00), and 5.1 percent (FY01). Hence, despite the continued negative impact from changes in tax law pertaining to the depreciation of computer equipment and an expanded number of exemptions, the robust economy resulted in a net increase in the personal property tax base over the past few years. Corporate personal property jumped 6.4 percent to reach an all-time high, while personal property for utility companies, despite an anticipated decline due to electric deregulation, grew 3.7 percent in FY01. As a result of solid growth in both real and personal property, the total assessable base grew 3.6 percent in FY01.

The third major tax category in the County is the combined transfer and recordation taxes. Tax collections of $102.4 million reached an all-time high in FY01 and exceeded the budget estimate by 12.7 percent. A mid-year revision of the FY01 revenue estimate for the aggregate real estate category reflected a significant share of the variance observed at the end of the fiscal year. Following a period of lackluster growth, receipts jumped 40 percent in FY98. As the real estate market continued to improve, this tax category experienced another 12 percent increase in FY99, moderating to 7 percent growth in FY00, and just 2.6 percent in FY01. However, even though combined transfer and recordation taxes grew a modest 2.6 percent, only the recordation tax grew 7.7 percent, while the transfer tax fell 0.1 percent in FY01. Some of the stronger growth in recordation taxes is related to a jump in mortgage refinancing, which does not impact the transfer tax, and the transfer of the administration and collection of the recordation tax from the Circuit Court to Montgomery County Department of Finance. The transfer of administration is expected to have resulted in increased collections in the final month of the fiscal year as the Circuit Court accelerated postings of receipts to ensure that all tax collections were posted prior to transferring the administration to the Finance Department, however this increase is one-time only.

In contrast to FY98 when transfer tax revenues grew from an exceptionally strong residential and commercial real estate market, only the residential portion continued to grow in subsequent fiscal years while collections from commercial transfers remained on a downward trend. Tax collections from residential transfers jumped another 25 percent (FY99), 11 percent (FY00), and slowing to just 1.8 percent in FY01 to reach a record $54.6 million. The number of residential transfers also increased at a solid pace throughout most of this period reaching 22,000 in FY00. However, even though the residential market remained solid, the number of residential transfers fell 4.5 percent to 21,005 in FY01. Hence, it was the jump in housing prices - average value of residential transfers - that compensated for the decline in the number of transfers.

As mentioned, the commercial sector diverted from the residential trend in FY99 with a 29 percent drop in total transfer tax collections, followed by a 2 percent drop in FY00, and a more significant 9.0 percent decline in FY01. The number of commercial transfers also fell sharply in the last two fiscal years, with declines of 17 percent (FY00) and 30 percent (FY01) reducing the number of transfers to 461 – the lowest level since FY95. In short, even though total transfer tax receipts declined just 0.1 percent in FY01, commercial transfers fell both in value and numbers, the number of residential transfers fell, while the growth in the value of residential transfers compensated for all the declines to keep overall tax collections almost flat in FY01. As the economy continues to slow in the subsequent fiscal year, demand for commercial space drops. This is already evident in the office vacancy rate that jumped to a five-year high in September 2001. This suggests that neither the level nor the value of commercial transfers will rebound soon. Similarly, weaker employment conditions will dampen further growth in residential transfers. This will, to some degree, be compensated for by very low mortgage interest rates that dropped to near 30-year lows at the close of FY01. Previously, the "wealth effect" from the unprecedented growth in the stock markets boosted demand for houses at the high-end of the market, pushing up the average residential transfer tax to a record $2,601 in FY01. Considering the negative "wealth effect" from the significantly deteriorated stock markets more recently, average residential transfer taxes are not expected to grow at the rates observed through FY01. This suggests that FY01 transfer and recordation tax collections have been the high-water mark, and that following a modest downward adjustment, real estate activity for the residential sector will be in line with the moderate population and residential replacement growth trends for the County.

The remaining tax sources - consisting of the hotel/motel, fuel/energy, telephone, and admissions taxes - came in $2.7 million (6.2 percent) above the combined budget estimate of $44.0 million in FY01. The continued growth in the County economy, employment, and real estate market, contributed to growth in revenues from the hotel/motel (26 percent) and, to a lesser degree, for the fuel/energy (7 percent) and telephone (4 percent) taxes compared to FY00. The sharp jump in hotel tax collections is due to several factors –accounting and economic. Expected late payments of this tax for the fourth quarter FY00 created a 4.9 percent drop in receipts that year, while boosting FY01 receipts with one-time higher collections. At the same time, growth in occupancy rates (3 percent), room rates (6 percent), and a growing number of hotel rooms in the County (2 percent), contributed to the 26 percent growth in tax revenues for the hotel/motel tax. The smallest of all tax revenues – admissions and amusement taxes – fell 16.7 percent compared to FY00 due to a correction, as reflected in lower payments in FY01, for an overpayment made by the Maryland State Comptroller to the County in FY00.

Investment income fell 22 percent in FY01 compared to FY00, contributing 7 percent of the total General Fund variability between budget and actual collections. In the General Fund, it was $5.0 million below the budget estimate of $22.0 million, reflecting a decline in the portfolio balance as a result of later than usual issuance of commercial paper. Even though the yield on cash equity increased modestly from 5.72 percent (FY00) to 6.16 percent (FY01), this masks the fact that rates increased sharply in the first half of FY01, but plummeted in the second half as a result of an unprecedented series of interest rate cuts by the Federal Reserve Board. Total pooled investment income on a budgetary basis (all funds and outside participants, excluding unrealized gains/losses) came in at $49.5 million, which reflects a 3 percent decline from the prior fiscal year. The decline in revenues is reflected in the "daily cash average" which fell from $890 million in FY00 to $804 million in FY01, but only modestly below the budget estimate of $826 million. Assuming a lower yield rate, total pooled investment income was estimated at $47.4 million in the FY01 budget. Considering the sharp drop in interest rates in calendar year 2001, with the federal funds rate falling 400 basis points from 6.5 to 2.5 percent, and with more interest rate cuts likely, yield on cash equity will remain depressed in FY02. At the same time, slower revenue growth will dampen portfolio growth.

Revenues for General Governmental functions (General, Special Revenue, and Debt Service Funds) and the changes in those functional revenue categories from FY00 to FY01 are presented below:

| Revenues by Source | Amount FY01 | Amount FY00 | Increase (Decrease) |
|---|---|---|---|
| Taxes | $ 1,736,554,257 | $ 1,664,359,903 | 4.34% |
| Licenses and Permits | 8,532,219 | 8,131,722 | 4.93% |
| Intergovernmental | 160,632,254 | 178,156,441 | (9.84%) |
| Charges for Services | 36,752,854 | 38,349,591 | (4.16%) |
| Fines and Forfeitures | 6,788,140 | 5,363,772 | 26.56% |
| Investment Income | 31,924,510 | 37,507,641 | (14.89%) |
| Miscellaneous | 7,453,323 | 7,984,760 | (6.66%) |
| **Total Revenues by Source** | $ 1,988,637,557 | $ 1,939,853,830 | 2.51% |

Significant revenue changes from FY00 to FY01 related to the General Fund are described above. The most significant change not related to the General Fund involves intergovernmental revenues. There was a delay in receiving state aid for the County's Ride-On program in the Mass Transit Facilities Special Revenue Fund amounting to $16 million. Since this amount, received subsequent to year-end, was not considered to be available for expenditure in FY01, it was not recognized as revenue for FY01.

## *Expenditures*

Expenditures for General Governmental functions (General, Special Revenue, and Debt Service Funds) and General Fund transfers to certain component units for educational purposes totaled $1,970.4 million in FY01, an increase of 6.8 percent over FY00. General Governmental expenditures and certain other uses (educational transfers) by function and the changes in those functional categories from FY00 to FY01 are presented below:

| Expenditures and Other Uses by Function | Amount FY01 | Amount FY00 | Increase (Decrease) |
|---|---|---|---|
| General Government | $ 153,016,968 | $ 143,117,682 | 6.92% |
| Public Safety | 277,697,812 | 260,800,496 | 6.48% |
| Public Works and Transportation | 95,995,963 | 109,177,626 | (12.07%) |
| Health and Human Services | 180,787,483 | 160,972,782 | 12.31% |
| Culture and Recreation | 59,624,936 | 59,310,643 | 0.53% |
| Community Development and Housing | 8,864,268 | 7,194,841 | 23.20% |
| Environment | 3,753,098 | 3,106,472 | 20.82% |
| Education | 1,031,238,650 | 946,442,024 | 8.96% |
| Debt Service | 159,404,074 | 155,241,180 | 2.68% |
| **Total Expenditures and Other Uses by Function *** | $ 1,970,383,252 | $ 1,845,363,746 | 6.77% |

* Excludes $140 million in bond anticipation notes retired through the issuance of general obligation bonds in FY01.

Included in all FY01 General Governmental functional categories, except education and debt service, are general wage adjustments and service increments, ranging from approximately 6.2 to 6.5 percent. Other significant expenditure changes, after consideration of wage adjustments and service increments, include the following:

- Public Works and Transportation:

  - FY00 purchases of Ride-On buses amounting to $15.2 million, of which $6.3 million was funded by the Mass Transit Facilities Special Revenue Fund and $8.9 million was funded by grants from Federal, State, and other sources.

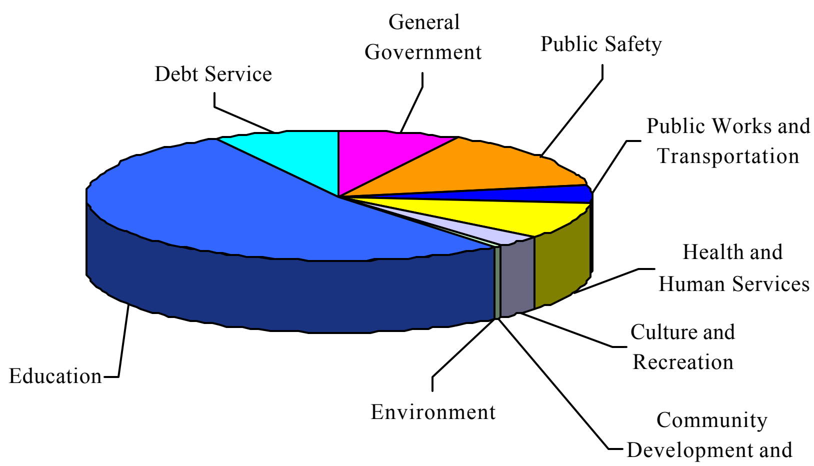
- Health and Human Services:

  - One-time funding of $2.3 million to private organizations, in some cases to match State bond bill funds, for the construction and/or renovation of educational, housing or community facilities;
  - An increase of $1.9 million for the Rewarding Work Initiative for child care, health, training and education services, and housing and transportation services to assist low wage earners in obtaining and maintaining employment;
  - Additional County funds of $1.8 million to replace the loss of Federal funds for services to persons with disabilities;
  - Additional funding of $830,000 to support mental heath providers;
  - Implementation of the Early Childhood Initiative of $790,000, which, with MCPS and private organizations, is designed to address the needs of children from before birth to age five to attain their full potential through quality early care, participation in appropriate programs, and the commitment of the community;
  - New or expanded initiatives of $400,000 relating to Afro-American health and Latin American health care; and
  - A Behavioral Health Initiative of $310,000 to provide mental health and substance abuse services, transportation at the point of intake at the detention center, and evaluations at the jail.

- Community Development and Housing:

  - Increases in the Community Development Block Grant and Home Program Grant.

**FY01 EXPENDITURES AND OTHER USES BY FUNCTION**




Source: Montgomery County Department of Finance

**Proprietary Operations**

The County operates a variety of enterprise activities which include solid waste disposal and collection activities, community use of public facilities, permitting services, four parking lot districts, and the nation's only county-controlled wholesale and retail liquor operation. The Liquor Enterprise Fund makes an annual operating transfer to the General Fund which, in FY01, amounted to $15.4 million. Significant financial balances and results of operations of all enterprise funds as of and for the year-ended June 30, 2001, include the following:

| | | | |
|---|---|---|---|
| Total Assets | $ 333,457,602 | Operating Revenues | $ 270,752,095 |
| Total Equities | $ 209,574,229 | Net Income | $ 25,346,876 |

The County maintains four internal service funds to account, on a cost reimbursement basis, for the financing of goods or services provided by one department to other departments and governments. Goods and services provided include motor pool operations, central duplicating services, liability and property coverage, and employee health benefits coverage. Charges for these services during FY01, to reimburse costs incurred, amounted to $108.8 million.

**Fiduciary Operations**

All component units participate in various pension plans, either directly in their own plan or through participation in pension systems of Montgomery County or the State of Maryland. HOC and MCRA participate in the Employees' Retirement System and Employees' Retirement Savings Plan of Montgomery County, and their data is included in that of the retirement system.

Financial data relative to the pension plans administered by the County or its component units, except BUPI which operates a simplified employee pension plan, is as follows:

| Plan Name | Covered Payroll | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL |
|---|---|---|---|---|
| Employees' Retirement System of Montgomery County | $ 290,751,709 | $ 1,990,882,017 | $ 2,111,946,453 | $ 121,064,436 |
| Employees' Retirement Savings Plan of Montgomery County | 73,641,600 | 23,909,060 | - | - |
| Montgomery County Public Schools Employees' Retirement and Pension System ** | 788,731,000 | 716,842,000 | 704,649,000 | (12,193,000) * |
| Montgomery Community College Aetna Plan | 6,408,983 | 12,681,277 | 9,592,981 | (3,088,296) * |

* Represents actuarial value of assets in excess of AAL
** FY00 data

| Plan Name | Employer Contributions | Employee Contributions | Number of Members | # of Persons Receiving or Entitled to Benefits |
|---|---|---|---|---|
| Employees' Retirement System of Montgomery County | $ 43,345,296 | $ 11,291,541 | 6,414 | 3,989 |
| Employees' Retirement Savings Plan of Montgomery County | 4,866,825 | 2,582,452 | 2,536 | 2,536 |
| Montgomery County Public Schools Employees' Retirement and Pension System | 16,511,474 | 3,816,195 | 28,492 | 10,228 * |
| Montgomery Community College Aetna Plan | - | 595 | 413 | 298 |
| * FY00 data | | | | |

The County and MCPS operate numerous fiduciary funds for the benefit of various trust agreements.

**Debt Administration**

At June 30, 2001, the County had outstanding general obligation bonds of $1,178,708,054 and outstanding bond anticipation notes (BANs) of $125 million. Over the last ten years, the County has issued its general obligation bonds once a year. With the passage of the Tax Reform Act of 1986, the County adopted a policy in 1988 of initially financing capital construction with BANs. Montgomery County also issues bonds to finance the capital construction of MCPS, MCC, and M-NCPPC not otherwise financed by the State of Maryland. Since FY92, the County has sold general obligation bond issues of up to $140 million. Over the last ten fiscal years, the County's annual issues have averaged about $112.5 million. The County's significant debt activities during FY01 were:

- In February 2001, the County issued general obligation bonds in the amount of $140 million. The proceeds of this bond issue were used to pay off an equal amount of the County's BANs.
- In May 2001, the County issued BANs in the amount of $105 million. Proceeds are being used to fund the County's capital program.
- In June 2001, the County issued Certificates of Participation for its Equipment Acquisition Program in the amount of $54.66 million. Proceeds are being used to fund the acquisition of radios, dispatch equipment, mobile computer equipment, and related items for the County's Public Safety Radio and Mobile Data Systems, and also for the acquisition of Ride On Buses.

The County continues to maintain its status as a top rated issuer of municipal securities, with the highest credit ratings possible for a local government. For its general obligation bonds, the County is a 'Triple AAA' rated County, and has received ratings of Aaa from Moody's Investors Service, Inc., AAA from Standard and Poor's, and AAA from Fitch, Inc. Montgomery County has consistently had a Aaa rating from Moody's Investors Service, Inc. since April 1973. Bonds issued by the County since July 1976 have consistently been rated AAA by Standard and Poor's.

As of June 30, 2001, Montgomery County is one of only seven 'Triple AAA' rated counties in the nation with a population greater than 800,000. According to Standard and Poor's, a deep, diverse, and growing economy; strong financial management; and a low debt burden are the hallmarks of counties rated 'AAA.' The rating category, by definition, represents extremely strong capacity to pay principal and interest. Typically, 'AAA' rated counties have demonstrated an ability to weather all economic cycles by maintaining tight budgetary controls, articulating and executing well-designed capital plans, maintaining sufficient reserves, and planning for future contingencies.

<u>Continuing Disclosure</u> - For purposes of complying with the County's continuing disclosure undertakings, this Comprehensive Annual Financial Report will be provided to each nationally recognized municipal securities information repository and to the state information depository, if any, established for Maryland. Individuals interested in the information to be provided pursuant to such continuing disclosure undertakings should refer to Exhibits A-1 through A-12 and Notes to the Financial Statements, as well as Tables 1 - 4, 6, and 8 - 12.

## Cash Management

The County maintains an active cash and investment management program. The primary objectives of these programs are the preservation of capital, providing liquidity to meet financial obligations, and maximization of the investment yield on short-term working capital.

Working capital is managed pursuant to the Annotated Code of Maryland, the County Code, and the County's investment policies as approved by the County Council. The County is authorized to invest in: a) obligations for which the United States has pledged its full faith and credit for the payment of principal and interest, b) obligations that a federal agency or instrumentality issues in accordance with an act of Congress, or c) repurchase agreements that any of the foregoing listed obligations secures. Cited statutes also authorize investments in bankers' acceptances, secured certificates of deposit issued by Maryland banks, commercial paper of the highest investment grade and in money market funds whose portfolio is operated consistent with the Securities and Exchange Commission rule 2a-7. The County requires that these money market funds invest only in obligations that a federal agency or instrumentality issues in accordance with an act of Congress and repurchase agreements collateralized by an obligation of the United States, its agencies, or instrumentalities. The average maturity of the County's working capital portfolio is generally less than six months. At June 30, 2001, the investment balance of the County's portion of the consolidated portfolios was $728.5 million and had earned investment income of $49.4 million for FY01.

## Risk Management

Montgomery County is self-insured for most claims filed by third parties. Property exposures are commercially insured above a high dollar retention. Potential losses are mitigated by a strong safety program, contractual transfer of exposure to others, and ongoing analysis of risk associated with County activities. In addition to the component units covered by this financial report, the following agencies are also members of the risk management program: Maryland-National Capital Park and Planning Commission, City of Rockville, Housing Authority of the City of Rockville, City of Gaithersburg, the Town of Somerset, the Village of Martin's Additions, and the Village of Drummond.

# INDEPENDENT AUDIT

Article 3, Section 315 of the County Charter requires that "the Council shall contract with, or otherwise employ, a certified public accountant to make annually an independent post-audit of all financial records and actions of the County, its officials and employees. The complete report of the audit shall be presented to the Council and copies of it shall be made available to the public." This requirement has been complied with and the auditors' opinion is included in this report. The Council has a policy that no certified public accounting firm shall be retained for more than two consecutive four year terms.

The County is required to undergo annual single audits in conformity with the provisions of the Single Audit Act of 1984 and the U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Information related to these audits, including schedules of Federal financial assistance, findings and recommendations, and auditors' reports on internal controls and compliance with applicable laws and regulations, are available from Montgomery County, MCPS, MCC, MCRA, and HOC. BUPI is not required to have a "Single Audit" as it receives no Federal grants.

## AWARDS AND RECOGNITION

### Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Montgomery County, Maryland, for its comprehensive annual financial report for the fiscal year-ended June 30, 2000. Montgomery County has received the Certificate of Achievement more times than any other county in the nation – thirty-one times – as early as 1951 and consecutively for twenty-nine years, since 1972.

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 government must publish an easily readable and efficiently organized comprehensive annual financial report. This report 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 Department of Finance believes its current report continues to meet the Certificate of Achievement Program's requirements and is submitting it to GFOA to determine its eligibility for another certificate.

### Distinguished Budget Presentation

GFOA presented an award of Distinguished Presentation to Montgomery County, Maryland, for its annual budget for the fiscal year beginning July 1, 2000. In order to receive this award, a governmental unit must publish a 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. Montgomery County has received this award consecutively since 1984, the year the program was established. The Office of Management and Budget believes the current budget continues to conform to program requirements and is submitting it to GFOA to determine its eligibility for another award.

## USE OF THIS REPORT

The Government Finance Officers Association of the United States and Canada reports a growing awareness that the Comprehensive Annual Financial Report should be management's report to its governing body, constituents, oversight bodies, resource providers, investors and creditors. I agree with this direction, and I continue to send copies of this report to elected officials, County management personnel, bond rating agencies, nationally recognized municipal securities information repositories, the State information depository, if any, and other agencies such as financial institutions and government agencies that have expressed an interest in the financial affairs of Montgomery County, Maryland.

In addition to the vast amount of financial information presented, there is included herein a Statistical Section containing comprehensive data which relates to the financial condition of the entire governmental structure of Montgomery County. Use of this report by the elected officials and department heads of the County is encouraged when furnishing information to interested parties. Considerable effort is being made to present financial information on a uniform and consistent basis nationwide, which will make this report all the more valuable to those desiring to secure information regarding the financial activities of the County.

This report, and other financial information prepared by the Montgomery County Department of Finance, can be accessed on the World Wide Web at http://www.co.mo.md.us/services/finance. Copies of this report are also being placed in the County Library System for use by the general public.

## ACKNOWLEDGMENTS

The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated services of the staff of the County's Department of Finance. I express my appreciation to all participants who assisted and contributed to its preparation. I particularly express my sincerest appreciation to Karen Q. Hawkins, CPA, CGFM, Controller, and her staff, particularly the General Accounting and Administration Sections, for their outstanding performance in the preparation of this report. A list of individuals who labored long and hard in preparing this report is provided separately after this letter. A special appreciation is extended to the finance and accounting managers of the component units whose cooperation greatly facilitated the preparation of this report. I express my appreciation to the County Executive, the members of the County Council and the Chief Administrative Officer and their staffs for their continuing interest and support in planning and conducting the financial operations of the County in a responsible and progressive manner.

Respectfully submitted,

**Timothy L. Firestine**
Director of Finance

## ACKNOWLEDGMENTS


The following individuals' efforts were instrumental in closing the County's funds and in preparing this Comprehensive Annual Financial Report:

**Department of Finance**

Joyce E. Boyd
Jan Clagett
Wayne Johnson
Marilyn C. Clement
Michelle S. Hwang
Jay Narang
Judson T. Williams
Michael E. Edelin, Sr.
Nancy C. Foster
Timothy D. Hughes
Karen J. Jackson
Susan Kaplan
Felix O. A. Ogunba
Stephen M. O'Malley
Catherine Patterson
Nora A. Ravarra
Claudia L. Stalker
Vasili Stavrakas
Darane Tiev
Lisa C. Yang
Richard D. Hands
Yvette A. Davenport
Josephine Gilbert
Michael Lawton

**Department of Public Works and Transportation**

Judy Sparks
Jo Ann Byrum
Florence Okolo
Heidi Chapman

**Department of Liquor Control**

Andy Brown
Richard J. Duthoy

The following individuals provided data and information for inclusion in this report:

**County Government**

**Department of Finance**

Jennifer Barrett
David J. Bernstein
Edwin J. Bouligny
Phavann Chhuan
Michael Coveyou
Terry Fleming
Ray Gulhar
Robert Hagedoorn
Glenn Wyman

**Office of Public Information**

Thomas Whorton

**Office of Management and Budget**

Robert K. Kendal
Nancy Moseley
Joseph Beach

**Department of Public Works and Transportation**

Thomas Huff
Bill Davidson
Edna McGraw
Tom Kusterer
Richard Taylor and the Print Shop

**Component Units**

**Montgomery County Public Schools**

Larry A. Bowers
Jack Dodson
Robert J. Doody

**Montgomery Community College**

Marshall Moore
Linda Hickey
Kenneth Mullinex

**Housing Opportunities Commission**

Linda Mansouri
Frances Hartley

**Montgomery County Revenue Authority**

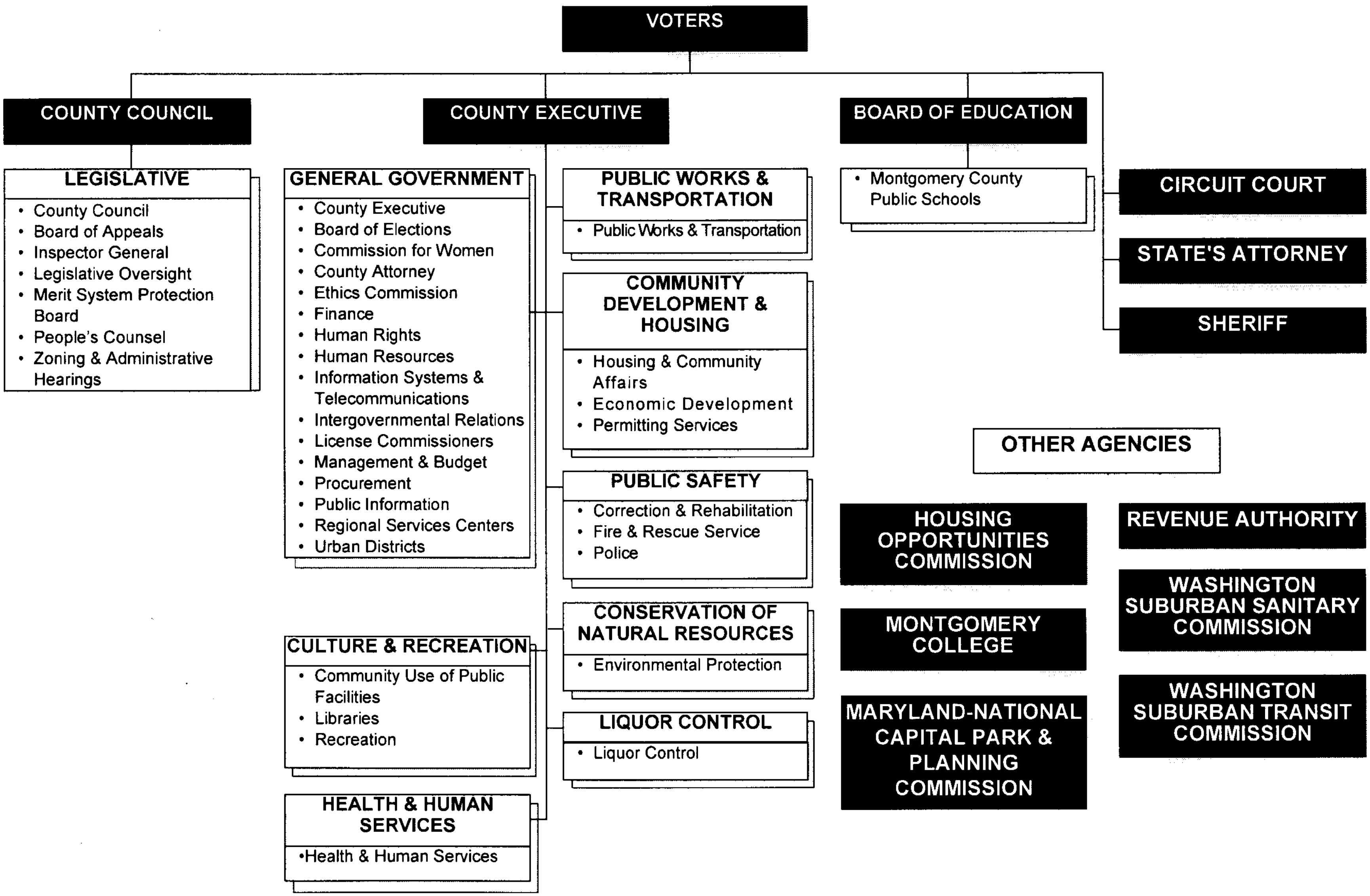
John Luke

**Bethesda Urban Partnership, Inc.**

Deborah Williams

Appreciation is extended to all those in the County Government who take a leadership role in the year-end closing processes and the audit process, including staff in Accounts Payable, Financial Systems Control, Payroll, Internal Audit, the Office of Management and Budget, the Office of Procurement, the Department of Information Systems and Telecommunications, and the Board of Investment Trustees. Appreciation is also extended to employees in all County departments and agencies who participate in the year-end process.

# MONTGOMERY COUNTY, MARYLAND
# FUNCTIONAL ORGANIZATION CHART



**MONTGOMERY COUNTY, MARYLAND**
**ELECTED OFFICIALS**
**June 30, 2001**

**COUNTY EXECUTIVE**
**Douglas M. Duncan**

**COUNTY COUNCIL**

| | |
|---|---|
| Blair G. Ewing | President |
| Steven Silverman | Vice President |
| | |
| Phil Andrews | Derick P. Berlage |
| Nancy Dacek | Howard A. Denis |
| Isiah Leggett | Marilyn Praisner |
| Michael L. Subin | |

**Other Elected Officials**

| | |
|---|---|
| Administrative Judge Circuit Court | Paul H. Weinstein |
| Clerk of the Circuit Court | Molly Q. Ruhl |
| Register of Wills | Joseph M. Griffin |
| Sheriff | Raymond M. Kight |
| State's Attorney | Douglas F. Gansler |

**APPOINTED OFFICIALS**

| | |
|---|---|
| Chief Administrative Officer | Bruce Romer |
| Board of Appeals | Katherine Freeman |
| Correction and Rehabilitation | Arthur Wallenstein |
| County Attorney | Charles W. Thompson, Jr. |
| County Council | Stephen B. Farber |
| Economic Development | David W. Edgerley |
| Environmental Protection | James A. Caldwell |
| Finance | Timothy L. Firestine |
| Fire and Rescue Service | Gordon A. Aoyagi |
| Health and Human Services | Charles L. Short |
| Housing and Community Affairs | Elizabeth B. Davison |
| Human Resources | Marta Brito Perez |
| Information Systems and Telecommunications | Alisoun K. Moore |
| Inspector General | Norman D. Butts |
| Intergovernmental Relations | Ben Bialek |
| Legislative Oversight | Karen Orlansky |
| Liquor Control | George Griffin |
| Management and Budget | Robert K. Kendal |
| Merit System Protection Board | Waddell Longus |
| People's Counsel | Martin Klauber |
| Permitting Services | Robert Hubbard |
| Police | Charles A. Moose |
| Procurement | Beatrice P. Tignor |
| Public Information | David S. Weaver |
| Public Libraries | Harriet Henderson |
| Public Works and Transportation | Albert J. Genetti, Jr. |
| Recreation | Gregory A. Bayor |
| Zoning and Administrative Hearings | Stephen B. Farber |

**Montgomery County Officials, Concluded**

## COMPONENT UNIT OFFICIALS

### Montgomery County Public Schools

**Board of Education:**
Nancy J. King, President
Kermit V. Burnett, Vice-President

| | |
|---|---|
| Steve Abrams | Sharon W. Cox |
| Reginald M. Felton | Walter N. Lange |
| Patricia B. O'Neill | Dustin Jeter<br>Student Member |

Jerry D. Weast, Superintendent of Schools

### Montgomery County Revenue Authority

**Board of Directors:**
Stephen Edwards, Chairman
Carol McGarry, Secretary-Treasurer

| | |
|---|---|
| Peter L. Gray | John Lane |
| John F. Wolf, Jr. | |

Marc D. Atz, Executive Director

### Bethesda Urban Partnership, Inc.

**Board of Directors:**
Robert E. Hebda, Chair
Benjamin W. King, Vice-Chair

Edward Hall Asher, Treasurer
Jason Hoffman, Secretary

| | |
|---|---|
| Robert G. Brewer, Jr. | Robyn Des Roches |
| Patricia A. Harris | Arnold J. Kohn |
| Page Lansdale | Gail Nachman |
| Jeanette Pfotenhauer | |

W. David Dabney, Executive Director

### Montgomery Community College

**Board of Trustees:**
Robert E. Shoenberg, Chair
Owen D. Nichols, First Vice-Chair
Gene W. Counihan, Second Vice-Chair

| | |
|---|---|
| Mary E. Cothran | Sylvia W. Crowder |
| Michael W. Gildea | Michael C. Lin |
| Roberta F. Shulman | Emil O. Parker, Student |

Charlene R. Nunley, President and Secretary/Treasurer

### Housing Opportunities Commission of Montgomery County

**Commissioners:**
Ralph D. Bennett, Jr., Chair
Richard Y. Nelson, Jr., Vice-Chair

| | |
|---|---|
| Norman Cohen | Monroe Galloway |
| Marjorie M. Harris | Charles T. Hopkins. |
| Warren Lasko | |

D. Scott Minton, Executive Director and Secretary Treasurer

## INDEPENDENT AUDITORS

KPMG LLP
2001 M Street, N.W.
Washington, DC 20036

# Elected Officials

## Montgomery County, Maryland

Douglas M. Duncan
County Executive

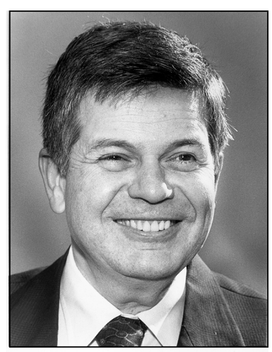
Blair Ewing
Council President

Steven Silverman
Council Vice-President

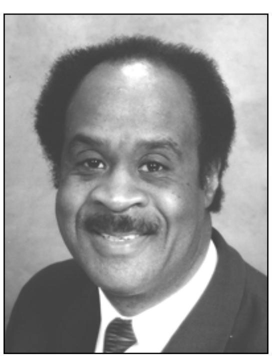
Phil Andrews
Council Member

Derick P. Berlage
Council Member

Nancy Dacek
Council Member



Howard Denis
Council Member



Isiah Leggett
Council Member

Marilyn Praisner
Council Member

Michael L. Subin
Council Member

**Prepared by the:**
**Department of Finance**
**Division of the Controller**
**101 Monroe Street**
**Rockville, Maryland 20850**
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