

**CITY OF PALACIOS, TEXAS**  
*ANNUAL FINANCIAL REPORT*  
For the Year Ended September 30, 2016

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## **INTRODUCTORY SECTION**

# City of Palacios, Texas

DIRECTORY OF PRINCIPAL OFFICIALS

September 30, 2016

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## City Officials

Glen Smith  
Johnny Tran  
Judy Chavez  
Mary Crocker  
Wayne Dodd  
Andy Erdelt  
Stephen McGovern

## Elective Position

Mayor  
Council Member  
Council Member  
Council Member  
Council Member  
Council Member  
Council Member

## Key Staff

David Kocurek  
Randall B. Strong  
Linh Chau  
Angela Flores  
David Miles  
Jackie Miller

## Appointive Position

City Manager  
City Attorney  
Municipal Court Judge  
City Secretary  
Chief of Police  
City Treasurer

## **FINANCIAL SECTION**

***Baker, Stogner & Associates***  
*Certified Public Accountants*

316 E. Jackson  
El Campo, TX 77437

(979) 543-3251  
(979) 543-6668 Fax

INDEPENDENT AUDITOR'S REPORT

To the City Council  
City of Palacios, Texas

**Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of September 30, 2016, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, budgetary comparison information, and historical pension information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial

reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Palacios, Texas' basic financial statements. The introductory section, combining and individual non-major fund financial statements, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining and individual non-major fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual non-major fund financial statements and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

#### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 14, 2017, on our consideration of the City of Palacios, Texas' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering City of Palacios, Texas' internal control over financial reporting and compliance.

***Baker, Stogner, and Associates***

El Campo, Texas

February 14, 2017

**CITY OF PALACIOS, TEXAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**September 30, 2016**

**As management of the City of Palacios, Texas (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended September 30, 2016.**

**FINANCIAL HIGHLIGHTS**

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$18,283,673 (*net position*). Of this amount, \$643,843 (*unrestricted net position*) may be used to meet the City's ongoing obligations to citizens and creditors.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$1,121,505, an increase of \$164,053 from the prior year. At the end of the current fiscal year, unassigned fund balance for the General Fund was \$924,829, or 38% of total General Fund expenditures.
- The City's total debt of business-type activities decreased by \$333,017 or 8% during the fiscal year, ending with a balance of \$4,714,434 of which \$328,234 is due within one year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also contains other supplemental information in addition to the basic financial statements themselves.

**Organization and Flow of Financial Section Information**

**Independent Auditors' Report**

*Provides the opinion of the Independent Auditors on the fair presentation of the basic financial statements.*

**Management's Discussion and Analysis**

*This supplementary information is required for state and local government financial statements and is intended to provide a narrative introduction and analysis.*

Pages 9 to 15

**Government-wide Financial Statements**

*Provides information on governmental and business-type activities of the primary government.*

Pages 18 to 20

**Fund Financial Statements**

*Provides information on the financial position of specific funds of the primary governments.*

Pages 22 to 30

**Notes to Financial Statements**

*Provides a summary of significant accounting policies and related disclosures.*

Pages 31 to 55

## **OVERVIEW OF THE FINANCIAL STATEMENTS - (Continued)**

### Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

### Statement of Net Position

The statement of net position presents information on all of the City's assets and liabilities, deferred inflows/outflows of resources, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

### Statement of Activities

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

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, health and welfare, and special services. The business-type activities of the City include water/wastewater and airport services.

### Fund Financial Statements

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

### Governmental Funds

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

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

The City maintained eleven individual governmental funds during the 2015-2016 fiscal year. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General Fund which is considered a major fund. Data from the other twelve governmental funds are combined into a single, aggregated presentation.

## **OVERVIEW OF THE FINANCIAL STATEMENTS - (Continued)**

### Governmental Funds - (Continued)

The City adopts an annual appropriated budget for its General Fund. A Schedule of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual has been provided to demonstrate compliance with the appropriated budget.

### Proprietary Funds

The City maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water/wastewater utility service and for its airport operations. Internal service funds are an accounting device used to accumulate and allocate costs internally among a government's various functions. The City's internal service fund is the Equipment Fund, which is used to account for the costs to maintain the City's fleet.

Proprietary funds provide the same type of information as the government-wide financial statements, only in a more detailed format. The proprietary fund financial statements provide information for the water/wastewater utility service and the airport operation; which are considered to be major funds of the City.

### Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs/operations. The accounting used for fiduciary funds is similar to proprietary funds.

### Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

### Other Information

In addition to the basic financial statements and accompanying notes, required supplementary information is included which presents a budgetary comparison schedule for the City's General Fund.

The combining statements referred to earlier in connection with nonmajor governmental funds are presented immediately following the required supplementary information.

## **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$18,283,673 at the close of the fiscal year 2016.

By far, the largest portion of the City's net position (96%) reflects its investment in capital assets (i.e., land, buildings, machinery and equipment), less a related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

**GOVERNMENT-WIDE FINANCIAL ANALYSIS - (Continued)**

<b>City of Palacios, Texas</b>						
<b>Net Position</b>						
	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
Current and other assets	\$ 1,599,092	\$ 1,588,194	\$ 702,767	\$ 696,396	\$ 2,301,859	\$ 2,284,590
Capital assets (net)	3,168,993	1,997,178	18,803,097	19,445,881	21,972,090	21,443,059
Other noncurrent assets	-	-	-	39,952	-	39,952
<b>Total assets</b>	<u>4,768,085</u>	<u>3,585,372</u>	<u>19,505,864</u>	<u>20,182,229</u>	<u>24,273,949</u>	<u>23,767,601</u>
Deferred Outflow of Resource	<u>300,665</u>	<u>159,293</u>	<u>98,062</u>	<u>15,917</u>	-	-
Current liabilities	139,739	253,346	558,169	547,668	697,908	801,014
Noncurrent liabilities	<u>1,204,877</u>	<u>1,024,549</u>	<u>4,373,608</u>	<u>4,649,634</u>	<u>45,578,485</u>	<u>5,674,183</u>
<b>Total liabilities</b>	<u>1,344,616</u>	<u>1,277,895</u>	<u>4,931,777</u>	<u>5,197,302</u>	<u>46,276,393</u>	<u>6,475,197</u>
Deferred Inflow of Resources	<u>84,228</u>	-	<u>28,382</u>	<u>38,254</u>	-	-
<b>Net Position</b>						
Invested in capital assets, net of related debt	3,155,498	1,955,942	14,484,332	14,833,358	17,639,830	16,789,300
Unrestricted	<u>484,408</u>	<u>395,672</u>	<u>159,435</u>	<u>166,232</u>	<u>643,843</u>	<u>561,904</u>
<b>Total net position</b>	<u>\$ 3,639,906</u>	<u>\$ 2,351,614</u>	<u>\$ 14,643,767</u>	<u>\$ 14,999,590</u>	<u>\$ 18,283,673</u>	<u>\$ 17,351,204</u>

The balance of unrestricted net position, \$643,843, may be used to meet the government's ongoing obligations to its citizens and creditors.

At the end of the current fiscal year, the City is able to report positive balances in all categories of net position for the primary government as a whole.

**GOVERNMENT-WIDE FINANCIAL ANALYSIS - (Continued)**

Governmental activities increased the City's net position by \$1,283,602. Business-type activities decreased the City's net position by \$351,764.

<b>City of Palacios, Texas</b>						
<b>Changes in Net Position</b>						
	Governmental		Business-type		Total	
	Activities	Activities	Activities	Activities	Activities	Activities
	2016	2015	2016	2015	2016	2015
<b>REVENUES</b>						
Program revenues:						
Charges for services	\$ 128,881	\$ 132,634	\$ 1,731,225	\$ 1,758,385	\$ 1,860,106	\$ 1,891,019
Operating grants and contributions	51,089	1,276	-	-	51,089	1,276
Capital grants and contributions	119,662	626,354	52,200	63,516	171,862	689,870
General revenues:						
Property taxes	1,410,607	1,370,380	-	-	1,410,607	1,370,380
Sales taxes	491,064	467,888	-	-	491,064	467,888
Franchise taxes	146,546	155,123	-	-	146,546	155,123
Other taxes	39,751	33,851	-	-	39,751	33,851
Unrestricted investment earnings	3,170	1,353	978	872	4,148	2,225
Miscellaneous	1,465,375	249,436	51,671	41,495	1,517,046	290,931
<b>Total revenues</b>	<b>3,856,145</b>	<b>3,038,295</b>	<b>1,836,074</b>	<b>1,864,268</b>	<b>5,692,219</b>	<b>4,902,563</b>
<b>EXPENSES</b>						
General government	747,329	692,372	-	-	747,329	692,372
Public safety	1,309,077	1,288,444	-	-	1,309,077	1,288,444
Public works	547,616	925,600	-	-	547,616	925,600
Special services	145,694	101,176	-	-	145,694	101,176
Health and welfare	38,644	36,353	-	-	38,644	36,353
Interest on long-term debt	-	2,232	-	-	-	2,232
Water and sewer	-	-	1,871,889	1,758,639	1,871,889	1,758,639
Airport	-	-	100,132	129,225	100,132	129,225
<b>Total expenses</b>	<b>2,788,360</b>	<b>3,046,177</b>	<b>1,972,021</b>	<b>1,887,864</b>	<b>4,760,381</b>	<b>4,934,041</b>
Change in net position before transfers	1,067,785	(7,882)	(135,947)	(23,596)	931,838	(31,478)
Transfers	215,817	209,244	(215,817)	(209,244)	-	-
Change in net position	1,283,602	201,362	(351,764)	(232,840)	931,838	(31,478)
Net position - beginning	2,356,304	2,150,252	14,995,531	15,232,430	17,351,835	17,382,682
Net position - ending	<b>\$3,639,906</b>	<b>\$2,351,614</b>	<b>\$ 14,643,767</b>	<b>\$ 14,999,590</b>	<b>\$ 18,283,673</b>	<b>\$ 17,351,204</b>

**FINANCIAL ANALYSIS OF THE CITY'S FUNDS**

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

**Governmental Funds**

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$1,121,505, an increase of \$164,053 from the prior year.

Approximately 82% of this total amount, \$924,829 constitutes unassigned fund balance, which is available for spending at the City's discretion. The remainder of fund balance of \$196,676 or 18% is non-spendable or restricted.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unassigned fund balance was \$924,829. Unreserved fund balance represents 38% of total General Fund expenditures.

The fund balance of the City's General Fund increased by \$132,970 during the current fiscal year. The increase was primarily due to the increase in tax revenue.

**Proprietary Funds**

The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net position of the Water and Sewer Fund at the end of the current fiscal year amounted to \$152,064. Unrestricted net position of the Airport Fund amounted to \$7,371 at the end of the current fiscal year. This is a decrease of \$351,764 from the prior year for the proprietary funds.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The City's investment in capital assets for its governmental and business-type activities amounts to \$21,945,177 (net of accumulated depreciation) at the end of the current fiscal year. This investment in capital assets includes land, buildings and improvements, vehicles, machinery and equipment, water and sewer system, and land structured facilities. The total decrease in the City's investment in capital assets was 16%.

<b>City of Palacios, Texas</b>						
<b>Capital Assets (Net of Depreciation)</b>						
	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
Land	\$ 357,286	\$ 357,286	\$ 8,129	\$ 8,129	\$ 365,415	\$ 365,415
Construction in progress	1,469,147	197,695	52,200	-	1,521,347	197,695
Buildings and improvements	587,401	579,752	144,145	227,273	731,546	807,025
Machinery and equipment	214,857	267,337	341,590	393,094	556,447	660,431
Land structured facilities	540,302	595,108	1,214,769	1,267,956	1,755,071	1,863,064
Water and sewer system	-	-	17,015,353	17,549,429	17,015,353	17,549,429
<b>Total</b>	<b><u>\$ 3,168,993</u></b>	<b><u>\$ 1,997,178</u></b>	<b><u>\$ 18,776,186</u></b>	<b><u>\$ 19,445,881</u></b>	<b><u>\$ 21,945,179</u></b>	<b><u>\$ 21,443,059</u></b>

Additional information on the City's capital assets can be found in Note 5 of this report.

## **CAPITAL ASSETS AND DEBT ADMINISTRATION - (Continued)**

### **Long-Term Debt**

During the 2011 fiscal year, the City issued \$3,580,000 in Certificate of Obligation Bonds in order to fund water and sewer improvements. The amount outstanding at year end is \$3,035,000. The 2011 bonds mature in 2031. In the 2010 fiscal year, the City was deeded certain water and sewer improvements that were constructed by a developer. The City has agreed to reimburse the developer certain costs that were incurred in the construction of the improvements. The net amount owed to the developer at year end was \$916,048. The City retired \$88,234 debt in the form of an eight year capital lease. Additional information on the City's long-term debt can be found in Note 10.

### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

The following factors were considered in preparing the City's budget for the 2016-2017 fiscal year.

The total sales tax payments received by the City from the State Comptroller in fiscal year 2016 totaled \$491,064. This amount is an increase of \$23,176 or 4.95% over the previous year.

The certified assessed taxable property valuations for the 2016 tax roll total \$177,335,096 with a tax rate of \$0.84 per \$100 valuation. \$0.84 was allocated for maintenance and operations. The projected total property tax due is \$1,460,000 for the 2016 tax year. The certified assessed taxable property valuations were more than the 2015 values.

Of the \$1,460,000 of projected 2015 property tax due, and using a 95% collection rate, \$77,162 is projected to be collected from the newly annexed Beachside subdivision. Of the \$77,162 projected collection, \$50,000 would be payable to the developer of the Beachside subdivision as per the City's development agreement.

The development agreement provides that in exchange for the developer's financing and extending of the off site water and sewer lines to the development, the City agreed to reimburse 75% of collected tax revenue and tap fees generated from the development site until the total reimbursement amount equals the extension costs. The amount of \$1,405,101 was agreed upon by the developer and the City for the extension of the water and sewer lines. As of the end of the fiscal year, \$489,053 had been reimbursed leaving a balance of \$916,048.

It is important to note that only taxes and fees actually collected will be subject to reimbursement and that funds reimbursed will only be generated from the development site.

The revenue needed to fund this debt is to be derived solely through increases in the water and sewer rates under a revised rate structure that encourages water conservation.

### **Requests for Information**

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Office, 311 Henderson Avenue, Palacios, Texas 77465.

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## **BASIC FINANCIAL STATEMENTS**

**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF NET POSITION**  
September 30, 2016

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 1,016,769	\$ 376,492	\$ 1,393,261	\$ 409,300
Receivables (net)	409,238	312,251	721,489	-
Internal balances	47,919	(47,919)	-	-
Due from other governments	112,499	-	112,499	29,058
Inventory	12,667	61,943	74,610	-
Total current assets	<u>1,599,092</u>	<u>702,767</u>	<u>2,301,859</u>	<u>438,358</u>
Noncurrent assets				
Capital assets				
Land and other assets not being depreciated	1,826,433	60,329	1,886,762	-
Buildings, improvements, and equipment (net)	1,342,560	18,715,855	20,058,415	-
Deferred expenses (net)	-	26,913	26,913	-
Total noncurrent assets	<u>3,168,993</u>	<u>18,803,097</u>	<u>21,972,090</u>	<u>-</u>
<b>Total assets</b>	<u>4,768,085</u>	<u>19,505,864</u>	<u>24,273,949</u>	<u>438,358</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
Deferred Outflows of Resources (net)	<u>300,665</u>	<u>98,062</u>	<u>398,727</u>	<u>10,254</u>
Total Deferred Outflow of Resources	<u>300,665</u>	<u>98,062</u>	<u>398,727</u>	<u>10,254</u>

**CITY OF PALACIOS, TEXAS**

STATEMENT OF NET POSITION (continued)

September 30, 2016

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable	\$ 30,440	\$ 75,161	\$ 105,601	\$ 156
Accrued expenses	44,959	7,714	52,673	1,236
Accrued interest payable	-	14,781	14,781	-
Due to other governments	17,026	-	17,026	-
Customer meter deposits	-	119,688	119,688	-
Accrued compensated absences	33,819	12,591	46,410	200
Payable to developer	-	50,000	50,000	-
Current portion of long-term obligations	13,495	278,234	291,729	-
Total current liabilities	<u>139,739</u>	<u>558,169</u>	<u>697,908</u>	<u>1,592</u>
Noncurrent liabilities				
Net Pension Liability	1,204,877	397,858	1,602,735	40,813
Noncurrent portion of long-term obligations	-	3,975,750	3,975,750	-
Total noncurrent liabilities	<u>1,204,877</u>	<u>4,373,608</u>	<u>5,578,485</u>	<u>40,813</u>
<b>Total liabilities</b>	<u>1,344,616</u>	<u>4,931,777</u>	<u>6,276,393</u>	<u>42,405</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Deferred Inflows of Resources (net)	84,228	28,382	112,610	2,817
Total Deferred Inflows of Resources	<u>84,228</u>	<u>28,382</u>	<u>112,610</u>	<u>2,817</u>
<b>NET POSITION</b>				
Invested in capital assets, net of related debt	3,155,498	14,484,332	17,639,830	-
Unrestricted	<u>484,408</u>	<u>159,435</u>	<u>643,843</u>	<u>403,390</u>
<b>Total net position</b>	<u>\$ 3,639,906</u>	<u>\$ 14,643,767</u>	<u>\$ 18,283,673</u>	<u>\$ 403,390</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF ACTIVITIES**  
*For the year ended September 30, 2016*

Function/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary Government</b>				
Governmental activities				
General government	\$ 747,329	\$ 31,486	\$ -	\$ -
Public safety	1,309,077	97,395	-	-
Public works	547,616	-	51,089	119,662
Special services	145,694	-	-	-
Health and welfare	38,644	-	-	-
Interest on long-term debt	-	-	-	-
Total governmental activities	<u>2,788,360</u>	<u>128,881</u>	<u>51,089</u>	<u>119,662</u>
Business-type activities				
Water and sewer	1,871,889	1,704,600	-	-
Airport	<u>100,132</u>	<u>26,625</u>	<u>-</u>	<u>-</u>
Total business-type activities	<u>1,972,021</u>	<u>1,731,225</u>	<u>-</u>	<u>-</u>
Total primary government	<u>\$ 4,760,381</u>	<u>\$ 1,860,106</u>	<u>\$ 51,089</u>	<u>\$ 119,662</u>
<b>Component Unit</b>				
Palacios Economic Development Corporation	<u>\$ 154,224</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

General revenues:  
Taxes:  
    Property taxes, levied for general purposes  
    Property taxes, levied for debt service  
    Sales taxes  
    Franchise taxes  
    Other taxes and fees  
Unrestricted investment earnings  
Miscellaneous  
Transfers  
Capital contributions  
Total general revenues and transfers  
Change in net position  
Net position - beginning  
Net position - ending

The accompanying notes are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Position			Component Unit
Primary Government			Palacios Economic Development Corporation
Governmental Activities	Business- type Activities	Total	
(715,843)	\$ -	\$ (715,843)	\$ -
(1,211,682)	-	(1,211,682)	-
(376,865)	-	(376,865)	-
(145,694)	-	(145,694)	-
(38,644)	-	(38,644)	-
-	-	-	-
<u>(2,488,728)</u>	<u>-</u>	<u>(2,488,728)</u>	<u>-</u>
-	(167,289)	(167,289)	-
<u>-</u>	<u>(73,507)</u>	<u>(73,507)</u>	<u>-</u>
-	(240,796)	(240,796)	-
<u>(2,488,728)</u>	<u>(240,796)</u>	<u>(2,729,524)</u>	<u>-</u>
-	-	-	(154,224)
1,401,004	-	1,401,004	-
9,603	-	9,603	-
491,064	-	491,064	163,688
146,546	-	146,546	-
39,751	-	39,751	-
3,170	978	4,148	924
1,465,375	51,671	1,517,046	16,860
215,817	(215,817)	-	-
-	52,200	52,200	-
<u>3,772,330</u>	<u>(110,968)</u>	<u>3,661,362</u>	<u>181,472</u>
1,283,602	(351,764)	931,838	27,248
<u>2,356,304</u>	<u>14,995,531</u>	<u>17,351,835</u>	<u>376,142</u>
<u>\$ 3,639,906</u>	<u>\$ 14,643,767</u>	<u>\$ 18,283,673</u>	<u>\$ 403,390</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS***BALANCE SHEET**GOVERNMENTAL FUNDS**September 30, 2016*

---

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	\$ 783,739	\$ 215,700	\$ 999,439
Receivables (net)	395,448	13,790	409,238
Due from other governments	111,640	859	112,499
Due from other funds	88,290	238	88,528
Inventory	12,667	-	12,667
<b>Total assets</b>	<u>1,391,784</u>	<u>230,587</u>	<u>1,622,371</u>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>Liabilities</b>			
Accounts payable	24,483	-	24,483
Accrued expenditures	44,959	-	44,959
Due to other funds	238	40,371	40,609
Due to other governments	12,224	4,802	17,026
<b>Total liabilities</b>	<u>81,904</u>	<u>45,173</u>	<u>127,077</u>
<b>Deferred Inflows of Resources</b>			
Unearned Revenue	372,384	1,405	373,789
<b>Total Deferred Inflow of Resources</b>	<u>372,384</u>	<u>1,405</u>	<u>373,789</u>
<b>Fund balances</b>			
Nonspendable	12,667	-	12,667
Restricted	-	184,009	184,009
Unassigned	924,829	-	924,829
<b>Total fund balances</b>	<u>937,496</u>	<u>184,009</u>	<u>1,121,505</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,391,784</u>	<u>\$ 230,587</u>	<u>\$ 1,622,371</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

*RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE TO NET POSITION  
OF GOVERNMENTAL ACTIVITIES*

*September 30, 2016*

---

<b>Total governmental fund balances</b>		<b>\$ 1,121,505</b>
<i>Amounts reported for governmental activities in the statement of net position are different because:</i>		
The Internal Service Fund is used by the City to account for the costs of equipment owned by the City. The assets and liabilities of the Internal Service Fund are included in governmental activities in the statement of net position.		115,837
Property taxes, fines and weedy lot receivables will be collected this year, but are not available soon enough to pay for the current period's expenditures, unearned revenue and therefore are deferred in the funds.		373,789
Capital assets used in governmental activities are reported as expenditures in governmental funds when purchased or constructed. The cost of these assets is \$8,381,309 and the accumulated depreciation is \$5,330,276.		3,051,033
Long-term liabilities are not due and payable in the current period and therefore are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:		
Net Pension Liability	\$ (1,204,877)	
Compensated absences	<u>(33,819)</u>	(1,238,696)
The net deferred outflows and inflows making up Net Pension Liability are not recorded in the funds		<u>216,438</u>
<b>Net position of governmental activities</b>		<b><u>\$ 3,639,906</u></b>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS***STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**GOVERNMENTAL FUNDS**For the year ended September 30, 2016*

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>REVENUES</b>			
Taxes	\$ 2,211,933	\$ 43,288	\$ 2,255,221
Licenses and permits	31,486	-	31,486
Intergovernmental	51,089	119,662	170,751
Charges for services	-	-	-
Fines and forfeitures	92,385	5,010	97,395
Investment income	2,686	431	3,117
Miscellaneous	153,289	1,207,219	1,360,508
<b>Total revenues</b>	<u>2,542,868</u>	<u>1,375,610</u>	<u>3,918,478</u>
<b>EXPENDITURES</b>			
Current			
General government	669,112	12,875	681,987
Public safety	1,166,396	-	1,166,396
Public works	423,370	1,323,652	1,747,022
Special services	145,694	-	145,694
Health and welfare	22,143	-	22,143
Debt service			
Principal retirement	-	-	-
Interest and fiscal charges	-	-	-
<b>Total expenditures</b>	<u>2,426,715</u>	<u>1,336,527</u>	<u>3,763,242</u>
Excess (deficiency) of revenues over expenditures	116,153	39,083	155,236
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in	158,600	-	158,600
Transfers out	(141,783)	(8,000)	(149,783)
<b>Total other financing sources (uses)</b>	<u>16,817</u>	<u>(8,000)</u>	<u>8,817</u>
Net change in fund balances	132,970	31,083	164,053
Fund balances (as restated), at beginning of year	<u>804,526</u>	<u>152,926</u>	<u>957,452</u>
<b>Fund balances at end of year</b>	<u>\$ 937,496</u>	<u>\$ 184,009</u>	<u>\$ 1,121,505</u>

The accompanying notes are an integral part of this statement.



**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF NET POSITION**  
**PROPRIETARY FUNDS**  
September 30, 2016

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 376,492	\$ -	\$ 376,492	\$ 17,330
Receivables (net)	311,951	300	312,251	-
Due from other funds	-	-	-	-
Inventory	52,823	9,120	61,943	-
Total current assets	741,266	9,420	750,686	17,330
Noncurrent assets				
Land and other assets not being depreciated	60,329	-	60,329	-
Buildings, improvements, and equipment (net)	17,506,446	1,209,409	18,715,855	117,959
Prepaid Interest	26,913	-	26,913	-
Total noncurrent assets	17,593,688	1,209,409	18,803,097	117,959
<b>Total assets</b>	<b>18,334,954</b>	<b>1,218,829</b>	<b>19,553,783</b>	<b>135,289</b>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
Contributions after 12/31/15 through 9/30/16	98,062	-	98,062	-
Total Deferred Outflows of Resources	98,062	-	98,062	-
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable	74,308	853	75,161	5,957
Accrued expenses	7,714	-	7,714	-
Due to other funds	46,723	1,196	47,919	-
Accrued interest payable	14,781	-	14,781	-
Customer meter deposits	119,688	-	119,688	-
Accrued compensated absences	12,591	-	12,591	-
Current portion of notes	88,234	-	88,234	13,495
Current portion of payable to developer	50,000	-	50,000	-
Current portion of general obligation bonds	190,000	-	190,000	-
Total current liabilities	604,039	2,049	606,088	19,452
Noncurrent liabilities				
Net Pension Liability	397,858	-	397,858	-
Notes payable	264,702	-	264,702	-
General obligation bonds	-	-	-	-
Certificates of obligation	2,845,000	-	2,845,000	-
Payable to developer	866,048	-	866,048	-
Total noncurrent liabilities	4,373,608	-	4,373,608	-
<b>Total liabilities</b>	<b>4,977,647</b>	<b>2,049</b>	<b>4,979,696</b>	<b>19,452</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Actual expense vs assumptions	28,382	-	28,382	-
Total Deferred Inflows of Resources	28,382	-	28,382	-
<b>NET POSITION</b>				
Invested in capital assets, net of related debt	13,274,923	1,209,409	14,484,332	104,464
Unrestricted net position	152,064	7,371	159,435	11,373
<b>Total net position</b>	<b>\$ 13,426,987</b>	<b>\$ 1,216,780</b>	<b>\$ 14,643,767</b>	<b>\$ 115,837</b>

The accompanying notes are an integral part of this statement 26

**CITY OF PALACIOS, TEXAS**

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION

PROPRIETARY FUNDS

For the year ended September 30, 2016

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>OPERATING REVENUES</b>				
Charges for services	\$ 1,704,600	\$ 12,448	\$ 1,717,048	\$ -
Rents	-	14,177	14,177	-
<b>Total operating revenues</b>	<u>1,704,600</u>	<u>26,625</u>	<u>1,731,225</u>	<u>-</u>
<b>OPERATING EXPENSES</b>				
Water system	704,706	-	704,706	-
Sanitary sewer system	295,829	-	295,829	-
Solid waste	-	-	-	-
Airport expenses	-	53,983	53,983	-
Miscellaneous	24,519	-	24,519	-
Equipment expenses	-	-	-	142,519
Depreciation and amortization	710,689	46,149	756,838	52,028
<b>Total operating expenses</b>	<u>1,735,743</u>	<u>100,132</u>	<u>1,835,875</u>	<u>194,547</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	(31,143)	(73,507)	(104,650)	(194,547)
<b>NONOPERATING REVENUES (EXPENSES)</b>				
Investment income	965	13	978	53
Connection fees	19,473	-	19,473	-
Miscellaneous income	1,356	7,105	8,461	-
Nonoperating lease income	-	23,737	23,737	-
Interest and fiscal charges	(136,146)	-	(136,146)	-
<b>Total nonoperating revenues (expenses)</b>	<u>(114,352)</u>	<u>30,855</u>	<u>(83,497)</u>	<u>53</u>
Income (loss) before contributions and transfers	(145,495)	(42,652)	(188,147)	(194,494)
Contributions and transfers				
Capital contributions	52,200	-	52,200	-
Transfers in	59,783	-	59,783	207,000
Transfers out	(275,600)	-	(275,600)	-
Total contributions and transfers	<u>(163,617)</u>	<u>-</u>	<u>(163,617)</u>	<u>207,000</u>
Change in net position	(309,112)	(42,652)	(351,764)	12,506
Total net position at beginning of year	<u>13,736,099</u>	<u>1,259,432</u>	<u>14,995,531</u>	<u>103,331</u>
<b>Total net position at end of year</b>	<u>\$ 13,426,987</u>	<u>\$ 1,216,780</u>	<u>\$ 14,643,767</u>	<u>\$ 115,837</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF CASH FLOWS**  
**PROPRIETARY FUNDS**  
For the year ended September 30, 2016

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Cash received from customers	\$ 1,703,125	\$ 27,550	\$ 1,730,675	\$ -
Cash paid to suppliers for goods and services	(696,605)	(46,951)	(743,556)	(145,377)
Cash paid to employees for services	(321,163)	-	(321,163)	-
<b>Net cash provided (used) by operating activities</b>	<u>685,357</u>	<u>(19,401)</u>	<u>665,956</u>	<u>(145,377)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>				
Transfers (to) from other funds	(215,817)	-	(215,817)	207,000
Borrowings (repayments) to other funds	-	(11,454)	(11,454)	-
Connection fees	19,473	-	19,473	-
Miscellaneous income (expense)	1,356	30,842	32,198	-
Increase (decrease) in customer meter deposits	1,200	-	1,200	-
<b>Net cash provided (used) by noncapital financing activities</b>	<u>(193,788)</u>	<u>19,388</u>	<u>(174,400)</u>	<u>207,000</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>				
Acquisition and construction of capital assets	(34,942)	-	(34,942)	(22,950)
Change in prepaid interest	13,039	-	13,039	-
Proceeds from issuance of debt	-	-	-	-
Principal paid on long-term debt	(333,017)	-	(333,017)	(27,742)
Interest paid	(136,840)	-	(136,840)	-
<b>Net cash provided (used) by capital and related financing activities</b>	<u>(491,760)</u>	<u>-</u>	<u>(491,760)</u>	<u>(50,692)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Investment income	965	13	978	53
<b>Net cash provided (used) by investing activities</b>	<u>965</u>	<u>13</u>	<u>978</u>	<u>53</u>
Net increase (decrease) in cash and cash equivalents	774	-	774	10,984
Cash and cash equivalents at beginning of year	375,718	-	375,718	6,346
<b>Cash and cash equivalents at end of year</b>	<u>\$ 376,492</u>	<u>\$ -</u>	<u>\$ 376,492</u>	<u>\$ 17,330</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

## STATEMENT OF CASH FLOWS

## PROPRIETARY FUNDS

For the year ended September 30, 2016

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	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>				
Operating income (loss)	\$ (31,143)	\$ (73,507)	\$ (104,650)	\$ (194,547)
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation and amortization	710,689	46,149	756,838	52,028
Changes in assets and liabilities				
(Increase) decrease in accounts receivable	(1,475)	925	(550)	-
(Increase) decrease in inventory	(4,306)	6,656	2,350	-
Increase (decrease) in accounts payable	3,269	376	3,645	(2,858)
Increase (decrease) in accrued expenses	(1,495)	-	(1,495)	-
Increase (decrease) in accrued pension	6,973	-	6,973	-
Increase (decrease) in compensated absences	<u>2,845</u>	<u>-</u>	<u>2,845</u>	<u>-</u>
Total adjustments	<u>716,500</u>	<u>54,106</u>	<u>770,606</u>	<u>49,170</u>
<b>Net cash provided (used) by operating activities</b>	<u>\$ 685,357</u>	<u>\$ (19,401)</u>	<u>\$ 665,956</u>	<u>\$ (145,377)</u>
<b>Noncash capital and related financing activities</b>				
Infrastructure improvements contributed by other Governments	<u>\$ 52,200</u>			

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

*STATEMENT OF FIDUCIARY NET POSITION*

*FIDUCIARY FUNDS*

*September 30, 2016*

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	<u>Agency Fund</u>
<b>ASSETS</b>	
Cash and cash equivalents	\$ <u>53,948</u>
<b>Total assets</b>	\$ <u><u>53,948</u></u>
<b>LIABILITIES</b>	
Liabilities	
Due to others	\$ <u>53,948</u>
<b>Total liabilities</b>	\$ <u><u>53,948</u></u>

The accompanying notes are an integral part of this statement.

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## **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The City of Palacios, Texas (the "City") was incorporated in 1909. The voters of the City passed a referendum during the May 3, 2003, election to form a Charter Commission and to elect a board of commissioners to frame the new charter. The Commission presented the Charter to the City Council and was passed by the voters during the November 2, 2004, election. The passing of the Charter allowed the City to change from a Type A General Law City to a Home Rule City with a Council-Manager form of government. Other changes allowed the Mayor's position to vote on all items and required a sixth Council position to be created which was filled in the November 2, 2004, election. The City Manager is responsible for law enforcement, appointment and removal of department directors and employees, supervision and control of all City departments, and preparation of the annual budget. The Mayor presides at meetings of the City Council and is allowed to vote on all matters. The City provides the following services: public safety to include police, fire, and emergency medical services, highways and streets, water and wastewater, sanitation, recreation, public improvements, planning and zoning, and general administration.

### **A. Reporting Entity**

In evaluating how to define the government, for financial reporting purposes, the City's management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in the Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, and as amended by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. Under these guidelines, the reporting entity consists of the primary government (all funds of the City), organizations for which the primary government is financially accountable, organizations for which the primary government is not financially accountable, organizations that raise and hold economic resources for the direct benefit of the primary government, and any other organization for which the nature and significance of their relationship with the primary government is such that exclusion could cause the City's financial statements to be misleading or incomplete. Entities other than the primary government that are included in the primary government's financial statements are called component units. The component unit discussed in this note is included in the City's financial statements because of the significance of its financial relationship with the City.

### **B. Component Unit**

The component unit is reported in a separate column to emphasize that it is legally separate from the City. The component unit column is made of the following:

The Palacios Economic Development Corporation (the "Corporation") was created for the purpose of benefiting and accomplishing public purposes of the City by promoting, encouraging, and enhancing the creation of jobs in the City. This is to be achieved through assistance in the retention of existing businesses and industries and the attraction of new businesses and industries and aid in their development and growth. Each Director of the Corporation is appointed to office by the City Council. Once appointed, they may be removed from office at will by a majority vote of the Council members. Under guidelines established by GASB, this fact makes the Corporation financially accountable to the City. Because other necessary conditions are also met, the Corporation has been included as a discretely presented component unit of the City in the accompanying financial statements. The Corporation uses the same fiscal year as the City and is presented as a governmental fund type. No other organizations met the necessary criteria to be considered component units of the City for the year ending September 30, 2016.

The component unit is discretely presented in the financial statements. Complete financial statements of the component unit can be obtained from Palacios City Hall, P.O. Box 845, Palacios, Texas 77465.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

C. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of changes in net position) report information on all non-fiduciary activities of the City and its component unit. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes, and intergovernmental revenues are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from its legally separate component units.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, fines, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the City.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation - (Continued)

The City reports the following major governmental fund:

The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The City reports the following major proprietary funds:

Enterprise Funds are used to account for operations: 1) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or 2) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Water and Sewer Fund, an enterprise fund, accounts for the activities of the City related to its sewage treatment plant and water distribution system.

The Airport Fund, an enterprise fund, accounts for the operation of the City's Airport.

Additionally, the City reports the following fund types:

The Special Revenue Funds account and report proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes other than debt service or capital projects.

The Debt Service Fund is used to account for and report financial resources that are restricted, committed or assigned to expenditure for general government debt principal and interest.

The Internal Service Fund is used to account for the City's equipment related expenses. Such operations are operated in a manner similar to private business enterprises, where the intent of the City is that the costs of providing equipment services to the various City departments on a continuing basis will be financed or recovered primarily through user charges to the departments.

The Agency Fund accounts for the collection of a deposit from a real estate developer. The funds will be used to pay for certain infrastructure improvements related to the development. The City has no ownership on these assets and are therefore excluded from the government-wide statements.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of GASB. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between various functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation - (Continued)

Amounts reported as program revenues include: 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise funds and the Internal Service Fund are charges to customers for sales and services. The Water and Sewer Fund also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first and then unrestricted resources as they are needed.

E. Budgets and Budgetary Accounting

The City follows these procedures in establishing the budgetary data reflected in the financial statements.

1. Prior to August 1, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted at City Hall to obtain taxpayer comments.
3. Prior to October 1, the budget is legally enacted through passage of an ordinance.
4. The City Manager is authorized to transfer budgeted amounts between line items within a department; however, any revisions that alter the total expenditures of any department must be approved by the City Council.
5. Formal budgetary integration was employed as a management control device during the year. The Debt Service Fund is not budgeted because effective budgetary control is alternatively achieved through general obligation bond indenture provisions.
6. All appropriations lapse at year-end. The City does not employ the use of encumbrances in its budgetary accounting.

F. Deposits and Investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

The City may invest its excess funds in any instruments authorized by the Public Funds Investment Act of Texas. Investments authorized under this Act include, but are not limited to, the following: Obligations of the United States or its agencies and instrumentalities; direct obligations of the State of Texas or its agencies and instrumentalities; collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

F. Deposits and Investments – (Continued)

underlying security for which is guaranteed by an agency or instrumentality of the United States; other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities; certificates of deposit issued by a state or financial institution domiciled in the State of Texas which is guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or otherwise secured; and certain repurchase agreements.

As of September 30, 2016, the City has adopted a formal investment policy.

G. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as “due to/from other funds”. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances”.

All trade and property tax receivables are shown net of an allowance for uncollectibles. Property tax receivables include unpaid property taxes at year-end along with penalties and interest assessed on these unpaid taxes. The allowance on the unpaid property taxes is equal to 10% of the outstanding property taxes and the allowance on the penalties and interest is equal to 75% of the assessed amount.

H. Inventory and Prepaid Items

Inventory is valued at the lower of cost (first-in, first-out) or market. Estimated cost is used when actual cost figures are not available. The costs of governmental fund-type inventories are recorded as expenditures when purchased rather than when consumed.

Certain payments to vendors reflect costs applicable to future accounting periods. These payments are reported as deferred expenditures (governmental funds) or prepaid expenses (proprietary funds) in the fund financial statements and as deferred expenditures/expenses in the government-wide financial statements.

I. Capital Assets

Capital assets, which include property, plant and equipment, are reported in the applicable governmental or business-type activities columns in the government-wide statement of net position. The City defines capital assets as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at

historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest is capitalized on capital assets of business-type activities when acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred during the period of construction until completion of the project with interest earned on invested proceeds over the same period.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

I. Capital Assets – (Continued)

Property, plant, and equipment of the primary government is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	50
Improvements other than buildings	40
Water and wastewater distribution system	40
Machinery and equipment	2-20
Office equipment and fixtures	3-15

J. Compensated Absences

The City allows ten days sick leave per year for each full-time employee and further allows each employee to accumulate up to ninety days of sick leave. Upon termination, there is no provision to pay the employee for accumulated sick days.

All full-time employees are given ten days vacation each year up to ten years of service and fifteen days per year thereafter. Employees may carryover a maximum of 80 hours of unused vacation time to the next year. Employees are paid for unused vacation time upon termination.

City employees can also earn compensatory time off for overtime hours worked. Employees have the option of either being paid for overtime work or taking additional time off at the rate of one and one-half hours in compensatory time for each hour of overtime worked. Most City personnel may accrue a maximum of 120 hours of compensatory time. Earned but unused compensatory time is paid to employees upon termination.

All compensated absences pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignation and retirement.

K. Long-Term Obligations

In the government-wide financial statements, and in proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net position. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. Losses or gains on refunding are capitalized and amortized over the shorter life of the new issuance or the life on existing debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

L. Deferred Outflows/Inflows of Resources

The statement of net position reports a separate section for deferred outflows of resources which follows the asset section. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) until then. The City has one item that qualifies for reporting in this category. It is the deferred amount calculated in the actuarial pension study required by Government Accounting Standards Board (GASB) Statement No. 68 "*Accounting and Financial Reporting for pensions*" (GASB No. 68) and the current year pension payments reported in the government-wide statement of net position.

In addition to liabilities, the statement of net position can also report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The City has two items that are considered deferred inflows of resources. One of the items arises only under a modified accrual basis of accounting and this item, *unavailable revenue*, is reported only in the government funds balance sheet. The government funds report unavailable revenues from a variety of sources and are further defined in Note 4. The other item that qualifies for reporting as a deferred inflow of resources is calculated in the actuarial pension study required by GASB 68. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

M. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and to pension expense, information about the fiduciary net position of the Texas Municipal Retirement System (TMRS) and additions to/deductions from TMRS's fiduciary net position have been determined on the same basis as they are reported by TMRS. For this purpose, plan contributions are recognized in the period that compensation is reported for the employee, which is when contributions are legally due. Benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at their fair value.

N. Fund Equity

Fund balances of Government Funds classified as restricted are balances with constraints placed on the use of resources by creditors, groups, contributors or laws or regulations of other governments. Fund balances classified as committed can only be used for specific purposes pursuant to constraints imposed by the Council through a resolution. Once the resolution is passed, the commitment remains in place until another resolution is passed to remove or revise the commitment.

Assigned fund balances are constrained by intent to be used for specific purposes but are neither restricted nor committed. The Council has by resolution authorized the City Manager or his/her designee to assign fund balance. Unlike commitments, assignments generally on exist temporarily and a formal action by the Council does not have to occur in order to remove the assignment.

For the classification of Governmental Fund balances, the City considers an expenditure to be made from the most restrictive first when more than one classification is available.

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**

O. Use of Estimates

The preparation of the government-wide and fund financial statements in conformity with generally accepted accounting principles requires the City to make estimates and assessments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenditures during the reporting period. Accordingly, actual results could differ from those estimates.

**NOTE 2: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**

Budgetary Compliance

There were two departments that expenditures exceeded the amount appropriated during the fiscal year 2015-2016.

<u>General Fund - Department</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Negative Variance</u>
Recycle Center	\$ 16,255	\$ 16,270	\$ (15)
Fire Department	48,920	50,820	(1,909)

These expenditures were funded by an available fund balance in the General Fund.

**NOTE 3: DEPOSITS AND INVESTMENTS**

The City's funds are required to be deposited and invested under the terms of a depository contract pursuant to the Texas Public Funds Investment Act. The depository bank pledges securities which comply with state law and these securities are held for safekeeping and trust with the City's and the depository bank's agent bank. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of FDIC insurance. Pledged securities at Compass Bank for the year ended 9/30/16 were \$1,945,000 in collateral value and \$1,990,473 in market value.

As of September 30, 2016, the City had the following investments:

<u>Investment Type</u>	<u>Amortized Cost</u>	<u>Weighted Average Maturity (Days)</u>
Public Funds Investment Pool		
TexPool	\$ 462,204	44

The pool operates in a manner consistent with the Securities and Exchange Commission's (SEC) Rule 2(a)(7) of the Investment Company Act of 1940 but is not registered with the SEC as an investment company. Instead, the regulatory oversight for the pool is the State of Texas. The pool uses amortized cost rather than market value to report net position to compute share prices. Accordingly, the fair value of the position in these pools is the same as the value of the shares in each pool.

Interest Rate Risk

In accordance with the City's investment policy, the City manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio to less than one year from the time of purchase. TexPool's weighted average maturity cannot exceed 60 days.

**NOTE 3: DEPOSITS AND INVESTMENTS (Continued)**

Credit Risk

The investment pool operates in full compliance with the Public Funds Investment Act. TexPool is rated AAAM by Standard & Poor's.

Concentration of Credit Risk

The City's investment policy requires that the investment portfolio shall be diversified in terms of investment instruments, maturity scheduling, and financial institutions to reduce the risk of loss resulting from over concentration of assets in a specific class of investments, specific maturity, or specific user. At year-end, the City was not exposed to concentration of credit risk.

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City's investment policy requires that deposits at financial institutions be insured by the FDIC and/or collateralized by securities pledged to the City by the depository in an amount equal to at least 110% of the carrying value of deposits held. During the fiscal year and at year-end, all deposits held in the depository bank were fully collateralized and therefore the City was not exposed to custodial credit risk. Pledged securities at Compass Bank for the year ended 9/30/16 were \$1,945,000 in collateral value and \$1,990,473 in market value.

Custodial Credit Risk - Investments

For an investment, this is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of the City's investments are invested in TexPool and it has no custodial credit risk.

**NOTE 4: RECEIVABLES**

Receivables at September 30, 2016, consist of the following:

	General	Water and Sewer	Airport Fund	Nonmajor Funds	Total
Gross Receivables:					
Accounts	\$ 48,965	\$ 477,890	\$ 300	\$ -	\$ 527,155
Ad valorem taxes	480,587	-	-	1,405	481,992
Franchise taxes	24,687	-	-	-	24,687
Fines	87,746	-	-	-	87,746
Other	-	678	-	12,385	13,063
Total gross receivables	641,985	478,568	300	13,790	1,134,643
Less: allowances	246,537	166,617	-	-	413,154
Total net receivables	<u>\$ 395,448</u>	<u>\$ 311,951</u>	<u>\$ 300</u>	<u>\$ 13,790</u>	<u>\$ 721,489</u>

**NOTE 4: RECEIVABLES (Continued)**

The City's governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. The governmental funds also defer revenue recognition in connection with resources that have been received, but not

yet earned. At the end of the current fiscal year, the various components of deferred revenue and unearned revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>	<u>Total</u>
General Fund			
Ad valorem taxes	\$ 286,015	\$ -	\$ 286,015
Fines	84,746	-	84,746
Weedy lot mowing	1,623	-	1,623
Debt Service Fund			-
Ad valorem taxes	<u>1,405</u>	-	<u>1,405</u>
Total	<u>\$ 373,789</u>	<u>\$ -</u>	<u>\$ 373,789</u>

The City's property taxes are levied annually on October 1<sup>st</sup> on the basis of the Appraisal District's assessed values as of January 1<sup>st</sup> of that calendar year. Appraised values are established by the Appraisal District at market value and assessed at 100% of appraised value. The City's property taxes are billed and collected by the Matagorda County Tax Assessor and are due and payable on January 31<sup>st</sup>. Such taxes are applicable to the fiscal year in which they are levied and become delinquent with an enforceable lien on the property on February 1<sup>st</sup> of the subsequent calendar year.

For the current year, the City levied property taxes of \$0.8400 per \$100 of assessed valuation. The entire amount was allocated for maintenance and operations. The resulting adjusted total tax levy was \$1,359,073 on the total adjusted taxable valuation of \$177,335,096 for the 2015 tax roll.

**NOTE 5: CAPITAL ASSETS**

The City's capital assets activity for the year ended September 30, 2016, was as follows:

	9/30/2015 Beginning Balance	Increases	Decreases	9/30/2016 Ending Balance
<b>Governmental Activities</b>				
Capital assets, not being depreciated				
Land	357,286			357,286
Construction in progress	197,695	1,271,452	-	1,469,147
Total capital assets not being depreciated	554,981	1,271,452	-	1,826,433
Capital assets being depreciated				
Machinery & Equipment	2,218,904	41,951		2,260,855
Land Structured Facilities	4,718,044			4,718,044
Buildings	919,830	27,435	-	947,265
Total capital assets being depreciated	7,856,777	69,386	-	7,926,163
Less accumulated depreciation for				
Machinery & Equipment	1,951,567	94,431		2,045,998
Land Structured Facilities	4,122,936	54,805		4,177,741
Buildings	340,076	19,788	-	359,864
Total accumulated depreciation	6,414,579	169,024	-	6,583,603
Total capital assets being depreciated, net	1,442,198	(99,638)	-	1,342,560
Governmental activities capital assets, net	1,997,179	1,171,814	-	3,168,993
<b>Business type activities</b>				
Capital assets, not being depreciated				
Land	8,129			8,129
Construction in progress	-	52,200	-	52,200
Total capital assets not being depreciated	8,129	52,200	-	60,329
Capital assets being depreciated				
Machinery & Equipment	1,073,579	7,500		1,081,079
Buildings & improvements	3,471,118	4,442		3,475,561
Water & sewer system	22,934,564	23,000		22,957,564
Land Structured Facilities	2,341,521	-	-	2,341,521
Total capital assets being depreciated	29,820,782	34,942		29,855,724
Less accumulated depreciation for				
Machinery & Equipment	680,485	56,861		737,346
Buildings & improvements	3,243,845	87,571		3,331,416
Water & sewer system	5,385,135	557,076		5,942,211
Land Structured Facilities	1,073,565	9,187	-	1,082,752
Total accumulated depreciation	10,383,031	710,696	-	11,093,727
Total capital assets being depreciated, net	19,437,751	(623,554)	-	18,761,997
Business type activities capital assets, net	19,445,880	(623,554)	-	18,822,326

**NOTE 5: CAPITAL ASSETS – (Continued)**

Depreciation expense was charged to functions/programs of the City as follows:

**Governmental Activities**

General Government	\$	65,919
Public Safety		43,946
Public Works		47,326
Public Health		11,833
	\$	<u>169,024</u>

**Business-type activities**

Utilities	\$	710,689
Airport		46,149
	\$	<u>756,838</u>

The Palacios Economic Development Corporation has \$12,799 of capital assets at September 30, 2016, consisting of various equipment and leasehold improvements. These assets were fully depreciated at September 30, 2016.

**NOTE 6: EMPLOYEES' RETIREMENT PLAN**

Plan Description

The City participates as one of 860 plans in the nontraditional, joint contributory, hybrid defined benefit pension plan administered by the TMRS. TMRS is an agency created by the State of Texas and administered in accordance with the TMRS Act, Subtitle G, Title 8, Texas Government Code (the TMRS Act) as an agent multiple-employer retirement system for municipal employees in the State of Texas. The TMRS Act places the general administration and management of the TMRS with a six-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas. TMRS's defined Benefit pension plan is a tax-qualified plan under Section 401 (a) of the Internal Revenue Code. TMRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at [www.tmr.com](http://www.tmr.com). All eligible employees of the City are required to participate in TMRS.

Benefits Provided

TMRS provides retirement, disability and death benefits. Benefit provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS. At retirement, the benefit is calculated as if the sum of the employee's contributions, with interest, and the City-financed monetary credits with interest were used to purchase an annuity. Members may choose to receive their retirement benefits in one of seven payments options. Members may also choose to receive a portion of their benefit as a partial lump sum distribution in an amount equal to 12, 24, or 36 monthly payments, which cannot exceed 75% of the member's deposits and interest.

The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS. Plan provisions of the City for plan year 2016 were as follows:

**NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)**

Employee deposit rate	7.00%
Matching ratio (City to employee)	2 to 1
Years required for vesting	5
Service retirement eligibility (expressed as age/years of service)	60/5, 0/20
Updated service credit	100.0 repeating
Annuity increase (to retirees)	70.0% of CPI

At the December 31, 2016 valuation and measurement date, the following employees were covered by the benefits terms:

Inactive employees or beneficiaries currently receiving benefits	19
Inactive employees entitled to but not yet receiving benefits	39
Active employees	<u>32</u>
	90

Contributions

The contribution rates for employees in TMRS are either 5%, 6%, or 7% of employees gross earnings, and the City matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of the City. Under the state law governing TMRS, the contribution rate for each City is determined annually by the actuary, using the Entry Age Normal (EAN) actuarial cost method. The actuarially determined rate is the estimated amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Employees for the City were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution plan rates for the City were 16.44% and 17.39% in calendar years 2014 and 2015, respectively. The City's contributions to TMRS for the fiscal year ended September 30, 2016 were \$229,252, and were equal to the required contributions.

Net Pension Liability

The City's Net Pension Liability (NPL) was measured as of December 31, 2015, and the Total Pension Liability (TPL) used to calculate the Net Pension Liability was determined by an actuarial valuation as of that date.

*Actuarial Assumptions*

The Total Pension Liability in the December 31, 2015 actuarial valuation was determined using the following actuarial assumptions:

**NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)**

Valuation Date	December 31st
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	30 Years
Asset Valuation Method	10 year Smoothed Market; 15% Soft Corridor
Inflation	2.50%
Overall Payroll Growth	3.00%
Salary Increases	3.50% to 10.50% including inflation
Investment Rate of Return*	6.75%
Retirement Age	Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2015 valuation pursuant to an experience study of the period 2010-2014.
Mortality	RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB.

Actuarial assumptions used in the December 31, 2015, valuation were based on the results of actuarial experience studies. The experience study in TMRS was for the period January 1, 2006 through December 31, 2009, first used in the December 31, 2010 valuation. Healthy post-retirement mortality rates and annuity purchase rates were updated based on a Mortality Experience Investigation Study covering 2009 through 2011, and dated December 31, 2013. These assumptions were first used in the December 31, 2013 valuation, along with a change to the Entry Age Normal (EAN) actuarial cost method. Assumptions are reviewed annually. No additional changes were made for the 2016 valuation.

The long-term expected rate of return on pension plan investments is 7%. The pension plan's policy in regard to the allocation of invested assets is established and may be amended by the TMRS Board of Trustees. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the largest asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

**NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)**

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return (Arithmetic)
Domestic Equity	17.50%	4.80%
International Equity	17.50%	6.05%
Core Fixed Income	30.00%	1.50%
Non-Core Fixed Income	10.00%	3.50%
Real Return	5.00%	1.75%
Real Estate	10.00%	5.25%
Absolute Return	5.00%	4.25%
Private Equity	<u>5.00%</u>	8.50%
 Total	 <u>100.00%</u>	

*Discount Rate*

The discount rate used to measure the Total Pension Liability was 7%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rates specified in statute. Based on that assumption, the pension's plan's Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability.

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
	(a)	(b)	(a) - (b)
<b>Balance at 12/31/2014</b>	\$ 5,097,583	\$ 3,712,108	\$ 1,385,475
Changes for the year:			-
Service cost	237,274	-	237,274
Interest	357,969	-	357,969
Changes of benefit terms	-	-	-
Difference between expected and actual experience	(4,265)	-	(4,265)
Change of assumptions	68,643	-	68,643
Contributions - Employer	-	241,493	(241,493)
Contributions - Employee	-	98,454	(98,454)
Net Investment Income	-	5,478	(5,478)
Benefit payments, including refunds			-
of employee contributions	(204,755)	(204,755)	-
Administrative expense	-	(3,336)	3,336
Other changes	-	(165)	165
Net changes	<u>454,866</u>	<u>137,169</u>	<u>317,697</u>
<b>Balance at 12/31/2015</b>	<u>\$ 5,552,449</u>	<u>\$ 3,849,277</u>	<u>\$ 1,703,173</u>

**NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)**

*Sensitivity of the Net Pension Liability to Changes in the Discount Rate*

The following presents the Net Pension Liability of the City, calculated using the discount rate of 7.0%, as well as what the City's Net Pension Liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.0%) or 1-percentage point higher (8.0%) than the current rate.

	1.0% Decrease in Discount Rate 5.75%	Current Single Rate Assumption 6.75%	1.0% Increase in Discount Rate (7.75%)
City's Net Pension Liability:	\$ 2,500,329	\$ 1,703,173	\$ 1,054,119

*Pension Plan Fiduciary Net Position*

Detailed information about the pension plan's fiduciary net position is available in a separately-issued TMRS financial report. That report may be obtained on the internet at [www.tmr.com](http://www.tmr.com).

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended September 30, 2016 the City recognized pension expense of \$232,471.

At September 30, 2016, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ (2,774)
Changes in actuarial assumptions	-	44,642
Difference between projected and actual investment earnings	203,496	-
Contributions subsequent to the measurement date	-	-
Total	\$ 203,496	\$ 41,868

\$448,176 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending September 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	Pension Expense Amount
2016	\$ 17,286
2017	51,173
2018	59,556
2019	50,874
2020	-
Thereafter	-
Total	\$ 178,889

**NOTE 7: SUPPLEMENTAL DEATH BENEFIT PLAN**

The City also participates in the cost sharing multiple-employer defined benefit group-term life insurance plan operated by TMRS known as the Supplemental Death Benefits Fund (SDBF). The City elected, by ordinance, to provide group-term life insurance coverage to both current and retired employees. The City may terminate coverage under and discontinue participation in the SDBF by adopting an ordinance before November 1<sup>st</sup> of any year to be effective the following January 1<sup>st</sup>.

The death benefit for active employees provides a lump-sum payment approximately equal to the employee’s annual salary (calculated based on the employee’s actual earnings, for the 12-month period preceding the month of death); retired employees are insured for \$7,500; this coverage is an “other postemployment benefit”, or OPEB.

**NOTE 8: RISK MANAGEMENT**

The City is exposed to various risks of loss encompassed in the areas of general liabilities, workers’ compensation claims, and employee health related expenses. The City has purchased general liability and workers’ compensation insurance to cover potential losses in those areas. The City has entered into interlocal agreements with the Texas Municipal League Intergovernmental Risk Pool for general liability and workers’ compensation coverage. Through the payment of contributions to the Texas Municipal

League Intergovernmental Risk Pool, the City has transferred these risks to the pool. The City has not retained any risks other than the deductible and is covered up to the limits of coverage after the deductible. Settlements of claims did not exceed insurance coverage for any of the past three years.

The City has also entered into an interlocal agreement with the Texas Municipal League Group Benefits Risk Pool for health insurance for its employees. The City pays the health care premiums for City employees. Employees have the option of paying dependent coverage via payroll deductions. The City has no liability for any claims incurred by participants in this plan.

**NOTE 9: LONG-TERM DEBT**

A. Changes in Long-Term Liabilities

Long-term liability activity for the year ended September 30, 2016, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental activities</b>					
Tax Notes	\$ -	\$ -	\$ -	\$ -	\$ -
Compensated absences	23,878	9,941	-	33,819	-
Net Pension Liability	1,011,056	193,821	-	1,204,877	-
Equipment notes	41,236	-	27,742	13,494	13,494
Total governmental activity long-term liabilities	<u>\$ 1,076,170</u>	<u>\$ 203,762</u>	<u>\$ 27,742</u>	<u>\$ 1,252,190</u>	<u>\$ 13,494</u>
<b>Business-type activities</b>					
General obligation bonds	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of obligation	3,220,000	-	185,000	3,035,000	190,000
Note Payable - Gov Cap Corp	441,170	-	88,234	352,936	88,234
Compensated absences	9,746	2,846	-	12,592	-
Net Pension Liability	335,868	61,990	-	397,858	-
Payable to developer	975,831	-	59,783	916,048	50,000
Total business-type activity long-term liabilities	<u>\$ 4,982,615</u>	<u>\$ 64,836</u>	<u>\$ 333,017</u>	<u>\$ 4,714,434</u>	<u>\$ 328,234</u>

**NOTE 9: LONG-TERM DEBT – (Continued)**

**B. General Obligation Refunding Bonds and Certificates of Obligation**

The City issued general obligation refunding bonds in October 2004 to retire the remaining balance of the 1994 general obligation bonds. General obligation refunding bonds are direct obligations and pledge the full faith and credit of the City. The bonds have been issued for both governmental and business-type activities. There is no bonds outstanding of the original 1994 issue.

The City issued certificates of obligation in March 2011 to provide for water and sewer capital improvements.

General obligation refunding bonds and certificates of obligation currently outstanding are as follows:

	<u>Term</u>	<u>Interest Rate</u>	<u>Original Amount</u>
Series 2011	2011 - 2031	2.00% - 4.375%	\$ 3,580,000

Annual debt service requirements to maturity for general obligation refunding and certificates of obligation are as follows

<u>Year</u>	<u>Business-type Activities</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2017	190,000	118,250	308,250
2018-2021	835,000	409,975	1,244,975
2022-2026	905,000	344,100	1,249,100
2027-2031	<u>1,105,000</u>	<u>145,500</u>	<u>1,250,500</u>
	<u>\$ 3,035,000</u>	<u>\$ 1,017,825</u>	<u>\$ 4,052,825</u>

**C. Tax Notes**

The City also issued tax notes to provide funds for the acquisition of major capital facilities payable from the proceeds of an annual ad valorem tax. The tax notes have been issued for governmental type activities.

	<u>Term</u>	<u>Interest Rate</u>	<u>Original Amount</u>
Tax Notes, Series 2008	2008 - 2015	3.25% - 4.25%	\$ 264,000

**NOTE 9: LONG-TERM DEBT – (Continued)**

D. Equipment Notes

The City financed equipment with capital leases. The annual debt service requirement and maturity are as follows:

Year	Business-type Activities		Total
	Principal	Interest	
2017	13,494	438	13,932
	<u>\$ 13,494</u>	<u>\$ 438</u>	<u>\$ 13,932</u>

Additionally, the City financed AMR systems and meters with capital leases. The annual debt obligation is as follows:

Year	Business-type Activities		Total
	Principal	Interest	
2017	77,638	10,596	88,234
2018	80,161	8,073	88,234
2019	82,767	5,467	88,234
2020	85,457	2,777	88,234
	<u>\$ 326,023</u>	<u>\$ 26,913</u>	<u>\$ 352,936</u>

E. Payable to Developer

In 2005, the City entered into a reimbursement contract with a land development company that was anticipating purchasing property for the development of a residential subdivision. The amount of the reimbursement was based on the amount spent on certain infrastructure improvements incurred in the development of the subdivision. The total expense incurred by the developer amounted to \$1,405,101. The City has agreed to pay the developer 75% of the property taxes collected based on a formula agreed upon by the parties. The City will continue to pay the developer on an annual basis until 100% of the \$1,405,101 has been repaid. The City has made payments of \$66,982, \$87,154, \$50,017, \$32,785, \$24,807, \$91,889, \$76,356 and \$59,783 for the 2009, 2010, 2011, 2012, 2013, 2014, 2015 and 2016 fiscal years, respectively. The City has recorded the net liability of \$916,048 in the accompanying financial statements. There is no predetermined repayment schedule since the amounts paid annually depend on the amount of taxes collected on certain properties. The accompanying financial statements reflect an estimated current portion of \$50,000.

**NOTE 10: INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS**

**A. Interfund Receivables and Payables**

At times during the fiscal year the various funds of the City were involved in transactions that created interfund receivable and payable balances. These transactions related to such things as the purchase of goods by one fund on behalf of another and the receipt of revenue in one fund that belongs to or is designated for another fund. Interfund receivable and payable balances as of September 30 2015, were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Airport	\$ 1,196
	Water & Sewer	46,723
	HOME	1,275
	Pavillion Restoration	39,096
Debt Service	General	238
		<u>\$ 88,528</u>

**B. Interfund Transfers**

Each year various funds of the City transfer funds to other funds. The most significant of these are the planned transfers from the City’s enterprise funds to specified governmental funds. These transfers are intended to provide the necessary resources to meet the operating and debt service obligations of the receiving funds. During the current fiscal year, transfers between funds consisted of the following:

<u>Transfers Out</u>	<u>Transfers In</u>			
	<u>General Fund</u>	<u>Equipment Fund</u>	<u>Water &amp; Sewer</u>	<u>Total</u>
General	\$ -	\$ 82,000	\$ 59,783	\$ 141,783
Nonmajor Governmental	8,000	-		8,000
Water & Sewer	150,600	125,000		275,600
Airport	-	-	-	-
	<u>\$ 158,600</u>	<u>\$ 207,000</u>	<u>\$ 59,783</u>	<u>\$ 425,383</u>

**NOTE 11: COMMITMENTS AND CONTINGENCIES**

**Grant Programs**

The City participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable at September 30, 2016, may be impaired. In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying combined financial statements for such contingencies.

**NOTE 12: FUND BALANCES**

The following is a detail of the governmental fund balances as of September 30, 2016:

	Governmental Fund Balances			
	Nonspendable	Restricted	Unassigned	Total
General				
Inventory	\$ 12,667	\$ -		\$ 12,667
Unassigned	-	-	924,829	924,829
Nonmajor Governmental	-		-	-
Retirement of long term debt	-	87,723	-	87,723
Municipal court	-	29,563	-	29,563
State and Federal grant programs	-	(13,871)	-	(13,871)
Public Safety	-	8,834	-	8,834
Tourism	-	71,760	-	71,760
	<u>\$ 12,667</u>	<u>\$ 184,009</u>	<u>\$ 924,829</u>	<u>\$ 1,121,505</u>

**NOTE 13: RESTATEMENT OF NET POSITION**

During the fiscal year 2016, the City removed a prior year credit of \$1,772.22 for refuse payable resulting in a restatement of General Fund Fund Balance of the same amount. The City also expensed prior year roll-off expenses resulting in a decrease of retained earnings in the Water Fund of \$4,058.51. The City increased beginning Fund Balance in the Hotel/Motel Fund \$2,918.00 for prior year tax.

**NOTE 14 TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM**

1. Plan Description

The Texas Emergency Services Retirement System (TESRS) administers a cost-sharing multiple employer pension system (the System) established and administered by the State of Texas to provide pension benefits for emergency services personnel who serve without significant monetary remuneration. Direct financial activity for the System is classified in the financial statements as pension trust funds. The System issues a stand-alone report financial report that is available to the public at [www.tesrs.org](http://www.tesrs.org).

Of the nine member state board of trustees, at least five trustees must be active members of the pension system, one of whom must represent emergency medical services personnel. One trustee may be a retiree of the pension system, and three trustees must be persons who have experience in the fields of finance, securities investment, or pension administration. At August 31, 2016, there were 199 contributing fire and/or emergency services department members participating in TESRS. Eligible participants include volunteer emergency services personnel who are members in good standing of a member department.

2. Benefits Provided

Senate Bill 411, 65<sup>th</sup> Legislature, Regular Session (1977), created TESRS and established the applicable benefit provisions. The 79<sup>th</sup> Legislature, Regular Session (2005), re-codified the provisions and gave the TESRS Board of Trustees authority to establish vesting requirements, contribution levels, benefit formulas, and eligibility requirements by board rule. The benefit provisions include retirement benefits as well as death and disability benefits. Members are 50% vested after the tenth year of service, with the vesting percent increasing 10% for each of the next five years of service so that a member becomes 100% vested with 15 years of service.

Upon reaching age 55, each vested member may retire and receive a monthly pension equal to his vested percent multiplied by six times the governing body's average monthly contribution over the member's years of qualified service. For years of service in excess of 15 years, this monthly benefit

is increased at the rate of 6.2% compounded annually. There is no provision for automatic postretirement benefit increases.

On and off-duty death benefits and on-duty disability benefits are dependent on whether or not the member was engaged in the performance of duties at the time of death or disability. Death benefits include a lump sum amount or continuing monthly payments to a member's surviving spouse or dependent children.

### 3. Covered Membership

At August 31, 2016, TESRS membership consisted of:

Retirees & Beneficiaries Currently Receiving Benefits	3,167
Terminated Members Entitled to Benefits, but not yet receiving them	2,200
Active Participants (Vested and Nonvested)	3,634

### 4. Funding Policy

Contributions are made by governing bodies for the participating departments. No contributions are required from the individuals who are members of the System, nor are they allowed. The governing bodies of each participating department are required to make contributions each month a member performs emergency services for a department (this minimum contribution is \$36 per member and the department may make a higher monthly contribution for its members). This is referred to as a Part One contribution, which is the legacy portion of the System contribution and directly impacts future retiree annuities.

The State is required to contribute an amount necessary to make the System "actuarially sound" each year, which may not exceed one-third of the total of all contributions made by participating governing bodies in a particular year.

The board rule defining contributions was amended effective July 27, 2014 to add the potential for actuarially determined Part Two contributions that would be required only if the expected future annual contributions from the state are not enough with the Part One contributions to provide an adequate contribution arrangement as determined by the most recent actuarial valuation. This Part Two portion, which is actuarially determined as a percent of the Part One portion (not to exceed 15%), is to be actuarially adjusted every two years based on the most recent actuarial valuation. Based on the actuarial valuation as of August 31, 2016, the Part Two contributions were established by the board to be 2% of the Part One contributions beginning September 1, 2017.

Additional contributions may be made by governing bodies within two years of joining the System, to grant up to ten years of credit for service per member. Prior service purchased must have occurred before the department began participating in the System.

A small subset of participating departments have a different contribution arrangement which is being phased out over time. In this arrangement, contributions made in addition to the monthly contributions for active members, are made by local governing bodies on a pay-as-you-go basis for members who were pensioners when their respective departments merged into the System. There is no actuarial impact associated with this arrangement as the pay-as-you-go contributions made by these governing bodies are always equal to benefit payments paid by the System.

### 5. Contributions Required and Contributions Made

The contribution requirement per active emergency services personnel member per month is not actuarially determined. Rather, the minimum contribution provisions were set by board rule, and there is no maximum contribution rate. For the fiscal year ending August 31, 2016, total contributions (dues, prior service and interest on prior service financing) of \$3,463,603 were paid into TESRS by the political subdivisions served by the member volunteer emergency services personnel. The State appropriated \$1,583,825 for the fiscal year ended August 31, 2016.

The purpose of the biennial actuarial valuation is to test the adequacy of the financing arrangement to determine if it is adequate to pay the benefits that are promised. Actuarial assumptions are disclosed below.

The most recently completed actuarial valuation as of August 31, 2016 stated that TESRS has an adequate contribution arrangement for the benefit provisions recognized in the valuation based on the expected total contributions, including the expected contributions both from the governing body of each participating department and from the state. The expected contributions from the state are state appropriations equal to (1) the maximum annual contribution (one-third of all contributions to TESRS by governing bodies of participating departments in a year) as needed in accordance with state law governing TESRS and (2) approximately \$725,000 each year to pay for part of the System's administrative expenses.

6. Actuarial Assumptions

The System's net pension liability was measured as of August 31, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of August 31, 2016.

Total pension liability	123,092,111
Plan fiduciary net position	<u>93,964,008</u>
System's net pension liability	29,128,103

Plan fiduciary net position as a percentage of the total pension liability	76.3%
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The total pension liability in the August 31, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Salary increases	N/A
Investment rate of return	7.75%, (net of pension plan investment expense, including inflation.)

Mortality rates were based on the RP-2000 Combined Healthy Lives Mortality Tables for males and for females projected to 2024 by scale AA.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future net real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These components are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation (3.00%). In addition, the final 7.75% assumption was selected by rounding down and thereby reflects a reduction of 0.22% for adverse deviation. The target allocation and expected arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Net Real Rate of Return
Equities		
Large cap domestic	32%	5.72%
Small cap domestic	10%	5.96%
Developed international	21%	6.21%
Emerging markets	6%	7.18%
Master limited partnership	5%	7.61%
Fixed income		
Domestic	21%	1.61%
International	5%	1.81%
Cash	0%	0.00%
Total	100%	
Weighted Average		4.97%

#### 7. Discount Rate

The discount rate used to measure the total pension liability was 7.75%. No projection of cash flows was used to determine the discount rate because the August 31, 2016 actuarial valuation showed that expected contributions would pay the normal cost and amortize the unfunded actuarial accrued liability (UAAL) in 30 years using the conservative level dollar amortization method. Because of the 30-year amortization period with the conservative amortization method, the pension plan's fiduciary net position is expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

#### 8. Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the System, calculated using the discount rate of 7.75%, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.75%) or 1 percentage point higher (8.75%) than the current rate.

	1% Decrease 6.75%	Current Discount Rate 7.75%	1% Increase 8.75%
System's net pension liability	\$ 49,314,321	\$ 29,128,103	\$ 16,266,418

#### **NOTE 15. SUBSEQUENT EVENTS**

The City approved the issuance of tax notes to provide funds for the completion of the Pavillion Restoration payable from the proceeds of an annual ad valorem tax. The tax notes will be issued for governmental type activities.

	Term	Interest Rate	Original Amount
Tax Notes Series 2017	2017-2024	2.15%	\$ 700,000

The first payment will be due 2/15/2018 and the final maturity 2/15/2024.

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## **REQUIRED SUPPLEMENTARY INFORMATION**

**CITY OF PALACIOS, TEXAS***MAJOR GOVERNMENTAL FUNDS - GENERAL FUND**SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE**BUDGET (GAAP BASIS) AND ACTUAL**For the year ended September 30, 2016*

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
<b>REVENUES</b>				
Taxes				
Ad valorem taxes	\$ 1,453,300	\$ 1,560,951	\$ 1,568,257	\$ 7,306
Other taxes	601,600	637,600	643,676	6,076
Licenses and permits	27,600	27,600	31,486	3,886
Intergovernmental	-	54,290	51,089	(3,201)
Charges for services	-	-	-	-
Fines and forfeitures	75,000	88,200	92,385	4,185
Investment income	1,500	1,500	2,686	1,186
Miscellaneous	113,400	147,800	153,289	5,489
<b>Total revenues</b>	<u>2,272,400</u>	<u>2,517,941</u>	<u>2,542,868</u>	<u>24,927</u>
<b>EXPENDITURES</b>				
Current				
General government	706,090	710,550	669,112	41,438
Public safety	1,138,880	1,168,490	1,166,396	2,094
Public works	337,360	481,711	423,370	58,341
Special services	144,000	210,140	145,694	64,446
Health and welfare	22,670	23,650	22,143	1,507
Debt service	-	-	-	-
<b>Total expenditures</b>	<u>2,349,000</u>	<u>2,594,541</u>	<u>2,426,715</u>	<u>167,826</u>
Excess (deficiency) of revenues over expenditures	(76,600)	(76,600)	116,153	192,753
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	158,600	158,600	158,600	-
Transfers out	(82,000)	(82,000)	(141,783)	(59,783)
<b>Total other financing sources (uses)</b>	<u>76,600</u>	<u>76,600</u>	<u>16,817</u>	<u>(59,783)</u>
Net change in fund balance	-	-	132,970	132,970
Fund balance at beginning of year	<u>804,526</u>	<u>804,526</u>	<u>804,526</u>	<u>-</u>
<b>Fund balance at end of year</b>	<u>\$ 804,526</u>	<u>\$ 804,526</u>	<u>\$ 937,496</u>	<u>\$ 132,970</u>

The accompanying notes to required supplementary information are an integral part of this schedule.

**Texas Municipal Retirement System**  
**Schedule of Changes in Net Pension Liability and Related Ratios**

Last 10 Years (will ultimately be displayed)

	<u>2014</u>	<u>2015</u>
<b>Total pension liability</b>		
Service Cost	\$ 218,395	237,274
Interest (on the Total Pension Liability)	346,962	357,969
Changes of Benefit Terms	-	-
Difference between expected and actual experience	(222,073)	(4,265)
Changes of assumptions	-	68,643
Benefit payments, including refunds of employee contributions	<u>(186,200)</u>	<u>(204,755)</u>
<b>Net Change in Total Pension Liability</b>	157,084	454,866
<b>Total Pension Liability - Beginning</b>	<u>4,940,499</u>	<u>5,097,583</u>
<b>Total Pension Liability - Ending (a)</b>	<u>\$ 5,097,583</u>	<u>\$ 5,552,449</u>
 <b>Plan Fiduciary Net Position</b>		
Contributions - Employer	216,636	241,493
Contributions - Employee	93,321	98,454
Net Investment Income	194,333	5,478
Benefit payments, including refunds of employee contributions	(186,200)	(204,755)
Administrative Expense	(2,028)	(3,336)
Other	<u>(167)</u>	<u>(165)</u>
<b>Net Change in Plan Fiduciary Net Position</b>	315,895	137,169
<b>Plan Fiduciary Net Position - Beginning</b>	<u>3,396,213</u>	<u>3,712,108</u>
<b>Plan Fiduciary Net Position - Ending (b)</b>	<u>\$ 3,712,108</u>	<u>\$ 3,849,277</u>
 <b>Net Pension Liability - Ending (a) - (b)</b>	1,385,475	1,703,172
 <b>Plan Fiduciary Net Position as a Percentage of Total Pension Liability</b>	72.82%	69.33%
 <b>Covered Employee Payroll</b>	\$ 1,333,150	\$ 1,406,483
 <b>Net Pension Liability as a Percentage of Covered Employee Payroll</b>	103.92%	121.09%

The accompanying notes to required supplementary information are an integral part of this schedule.

## Schedule of Employer Contributions

Last ten years

	<u>2015</u>	<u>2,016</u>
Actuarially Determined Contribution	\$ 229,252	\$ 228,157
Contribution in relation to the actuarially determined contribution	<u>(233,693)</u>	<u>(241,493)</u>
Contribution Deficiency (excess)	<u>\$ (4,441)</u>	<u>\$ (13,336)</u>
Covered employee payroll	\$ 1,423,754	\$ 1,406,483

Contributions as a percentage of coverage employee payroll

Information for the prior fiscal years was not readily available. The City will compile the respective information over the next several fiscal years.

The accompanying notes to required supplementary information are an integral part of this schedule.

**Texas Emergency Services Retirement System**  
**Schedule of Changes in the System's Net Pension Liability and Related Ratios for the**  
**Last 10 Fiscal Years**

	Fiscal Year Ending		
	8/31/2014	8/31/2015	8/31/2016
<b>1. Total Pension Liability</b>			
a. Service cost	\$ 1,827,592	\$ 1,694,230	\$ 1,694,230
b. Interest	8,051,287	8,470,723	8,901,986
c. Changes of benefit terms	-	-	722,024
d. Differences between expected and actual experience	-	-	64,648
e. Assumption changes	-	-	890,002
f. Benefit payments	(4,168,134)	(4,498,761)	(4,701,770)
<b>g. Net Change</b>	5,710,745	5,666,192	7,571,120
<b>h. Total - Beginning</b>	104,144,054	109,854,799	115,520,991
<b>i. Total - Ending</b>	\$ 109,854,799	\$ 115,520,991	\$ 123,092,111
<b>2. Plan Fiduciary Net Position</b>			
a. Contributions for participating departments	\$ 4,176,659	\$ 3,515,546	\$ 3,463,603
b. Contributions by the state	1,530,343	1,637,308	1,583,825
c. Net investment income	11,908,321	(3,292,889)	4,956,730
d. Benefit payments	(4,168,134)	(4,498,761)	(4,701,770)
e. Administrative expenses	(165,669)	(215,900)	(166,840)
<b>f. Net Change</b>	13,281,520	(2,854,696)	5,135,548
<b>g. Total - Beginning</b>	78,401,636	91,683,156	88,828,460
<b>h. Total - Ending</b>	\$ 91,683,156	\$ 88,828,460	\$ 93,964,008
<b>3. System's Net Pension Liability - Ending [Item 1 (i) - 2(h)]</b>	18,171,643	26,692,531	29,128,103
<b>4. Plan Fiduciary Net Position as a Percent of the Total Pension Liability</b>	83.5%	76.9%	76.3%
<b>5. Number of Active Members</b>	4,036	4,036	3,634
<b>6. System's Net Pension Liability per Active Member</b>	\$ 4,502	\$ 6,614	\$ 8,015

**Texas Emergency Service Retirement System  
Schedule of Investment Returns for the Last Ten Fiscal Years**

<b>Fiscal Year Ending</b>	<b>Annual Money-Weighted Net Real Rate of Return</b>
<b>August 31, 2013</b>	<b>13.84%</b>
<b>August 31, 2014</b>	<b>14.92%</b>
<b>August 31, 2015</b>	<b>-3.58%</b>
<b>August 31, 2016</b>	<b>5.57%</b>

**CITY OF PALACIOS, TEXAS**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**

September 30, 2016

**NOTE 1: BUDGETARY BASIS OF ACCOUNTING**

The City annually adopts budgets that are prepared using the modified accrual basis of accounting, which is consistent with generally accepted accounting principles.

**NOTE 2: BUDGETARY LEGAL COMPLIANCE**

For the year ended September 30, 2016 the City complied with budgetary restrictions at all departmental levels except the following. The following table details these variances:

<u>General Fund - Department</u>	<u>Final Budget</u>	<u>Negative Actual</u>	<u>Variance</u>
Fire Department	\$48,920	\$50,820	\$(1,900)
Recycle Center	\$16,255	\$16,270	\$ (15)

**NOTE 3. TEXAS MUNICIPAL RETIREMENT SYSTEM**

Valuation Date

Actuarially determined contribution rates are calculated as of December 31 and become effective in January 13 months later.

Valuation Date	December 31st
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	30 Years
Asset Valuation Method	10 year Smoothed Market; 15% Soft Corridor
Inflation	2.50%
Overall Payroll Growth	3.00%
Salary Increases	3.50 % to 10.50% including inflation
Investment Rate of Return*	6.75%
Retirement Age	Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2015 valuation pursuant to an experience study of the period 2010-2014.
Mortality	RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB.

**CITY OF PALACIOS, TEXAS**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**

*September 30, 2016*

**NOTE 4. TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM**

- A. This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten-year trend is compiled, only available information is shown.
- B. Determined from the end of the year total pension liability using the roll back procedure allowed for the initial year of implementing GASB 67.
- C. There is no compensation for active members, so number of active members is used instead.
- D. Determined from the beginning of year total pension liability using the roll forward procedure allowed by GASB 67.
- E. This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten-year trend is compiled, only available information is shown.
- F. The money-weighted rate of return expresses investment performance, net of investment expenses, reflecting the changing amounts actually invested during the year.

**COMBINING AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES**

**CITY OF PALACIOS, TEXAS**  
**NONMAJOR GOVERNMENTAL FUNDS**  
**COMBINING BALANCE SHEET**  
September 30, 2016

	Special Revenue Funds		
	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
<b>ASSETS</b>			
Cash and cash equivalents	\$ 59,375	\$ -	\$ 25,000
Receivables (net)			
Taxes	12,385	-	-
Other	-	-	-
Due from other funds	-	-	-
<b>Total assets</b>	<u>\$ 71,760</u>	<u>\$ -</u>	<u>\$ 25,000</u>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities			
Accounts payable	\$ -	\$ -	\$ -
Due to other funds	-	-	39,096
Deferred revenue	-	-	-
Due to other governments	-	-	-
<b>Total liabilities</b>	<u>-</u>	<u>-</u>	<u>39,096</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>			
Unearned revenues	-	-	-
<b>Total Deferred Inflows of Resources</b>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances			
Restricted			
Public safety	-	-	-
Tourism	71,760	-	-
State and federal grant programs	-	-	(14,096)
Municipal court	-	-	-
Debt service	-	-	-
<b>Total fund balances</b>	<u>71,760</u>	<u>-</u>	<u>(14,096)</u>
<b>Total liabilities and fund balances</b>	<u>\$ 71,760</u>	<u>\$ -</u>	<u>\$ 25,000</u>

The accompanying notes are an integral part of this statement.

Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency
\$ -	\$ 14,207	\$ 15,356	\$ 11,625	\$ 2,011
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
<u>\$ -</u>	<u>\$ 14,207</u>	<u>\$ 15,356</u>	<u>\$ 11,625</u>	<u>\$ 2,011</u>
\$ -	\$ -	\$ -	\$ -	\$ -
1,275	-	-	-	-
-	-	-	-	-
-	-	-	4,802	-
<u>1,275</u>	<u>-</u>	<u>-</u>	<u>4,802</u>	<u>-</u>
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	6,823	2,011
-	-	-	-	-
(1,275)	-	-	-	-
-	14,207	15,356	-	-
-	-	-	-	-
<u>(1,275)</u>	<u>14,207</u>	<u>15,356</u>	<u>6,823</u>	<u>2,011</u>
<u>\$ -</u>	<u>\$ 14,207</u>	<u>\$ 15,356</u>	<u>\$ 11,625</u>	<u>\$ 2,011</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**  
**NONMAJOR GOVERNMENTAL FUNDS**  
**COMBINING BALANCE SHEET**  
*September 30, 2016*

	Disaster Recovery Fund	Debt Service Fund	Total
<b>ASSETS</b>			
Cash and cash equivalents	\$ 1,500	\$ 86,626	\$ 215,700
Receivables (net)			
Taxes	-	1,405	13,790
Other	-	859	859
Due from other funds	-	238	238
<b>Total assets</b>	<u>\$ 1,500</u>	<u>\$ 89,128</u>	<u>\$ 230,587</u>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities			
Accounts payable	\$ -	\$ -	\$ -
Due to other funds	-	-	40,371
Deferred revenue	-	-	-
Due to other governments	-	-	4,802
<b>Total liabilities</b>	<u>-</u>	<u>-</u>	<u>45,173</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>			
Unearned revenues	-	1,405	1,405
<b>Total Deferred Inflows of Resources</b>	<u>-</u>	<u>1,405</u>	<u>1,405</u>
Fund balances			
Restricted			
Public safety	-	-	8,834
Tourism	-	-	71,760
State and federal grant programs	1,500	-	(13,871)
Municipal court	-	-	29,563
Debt service	-	87,723	87,723
<b>Total fund balances</b>	<u>1,500</u>	<u>87,723</u>	<u>184,009</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,500</u>	<u>\$ 89,128</u>	<u>\$ 230,587</u>

(concluded)

The accompanying notes are an integral part of this statement.

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**CITY OF PALACIOS, TEXAS**

NONMAJOR GOVERNMENTAL FUNDS

COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the year ended September 30, 2016

	Special Revenue Funds		
	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
<b>REVENUES</b>			
Taxes			
Hotel - motel tax	\$ 33,685	\$ -	\$ -
Ad valorem taxes	-	-	-
Court fees	-	-	-
Intergovernmental	-	52,200	62,942
Investment income			
Interest	123	-	28
Miscellaneous	-	-	1,207,219
<b>Total revenues</b>	<u>33,808</u>	<u>52,200</u>	<u>1,270,189</u>
<b>EXPENDITURES</b>			
Current			
General government			
Promotional expense	12,250	-	-
Public works	-	52,200	1,271,452
Principal			
Interest	-	-	-
<b>Total expenditures</b>	<u>12,250</u>	<u>52,200</u>	<u>1,271,452</u>
Excess (deficiency) of revenues over expenditures	21,558	-	(1,263)
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in (out)	(8,000)	-	-
<b>Total other financing sources (uses)</b>	<u>(8,000)</u>	<u>-</u>	<u>-</u>
Net change in fund balances	13,558	-	(1,263)
Fund balances at beginning of year (as restated)	<u>58,202</u>	<u>-</u>	<u>(12,833)</u>
<b>Fund balances at end of year</b>	<u>\$ 71,760</u>	<u>\$ -</u>	<u>\$ (14,096)</u>

The accompanying notes are an integral part of this statement.

Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency
\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	-	-
-	2,737	2,055	-	218
4,520	-	-	-	-
-	30	34	16	4
-	-	-	-	-
<u>4,520</u>	<u>2,767</u>	<u>2,089</u>	<u>16</u>	<u>222</u>
-	-	-	-	-
-	-	-	625	-
-	-	-	-	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>625</u>	<u>-</u>
4,520	2,767	2,089	(609)	222
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
4,520	2,767	2,089	(609)	222
<u>(5,795)</u>	<u>11,440</u>	<u>13,267</u>	<u>7,432</u>	<u>1,789</u>
<u>\$ (1,275)</u>	<u>\$ 14,207</u>	<u>\$ 15,356</u>	<u>\$ 6,823</u>	<u>\$ 2,011</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

## NONMAJOR GOVERNMENTAL FUNDS

## COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the year ended September 30, 2016

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	Disaster Recovery Fund	Debt Service Fund	Total
<b>REVENUES</b>			
Taxes			
Hotel - motel tax	\$ -	\$ -	\$ 33,685
Ad valorem taxes	-	9,603	9,603
Court fees	-	-	5,010
Intergovernmental	-	-	119,662
Investment income			
Interest	-	196	431
Miscellaneous	-	-	1,207,219
<b>Total revenues</b>	<u>-</u>	<u>9,799</u>	<u>1,375,610</u>
<b>EXPENDITURES</b>			
Current			
General government			
Promotional expense	-	-	12,875
Public works	-	-	1,323,652
Principal	-	-	-
Interest	-	-	-
<b>Total expenditures</b>	<u>-</u>	<u>-</u>	<u>1,336,527</u>
Excess (deficiency) of revenues over expenditures	-	9,799	39,083
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in (out)	-	-	(8,000)
<b>Total other financing sources (uses)</b>	<u>-</u>	<u>-</u>	<u>(8,000)</u>
Net change in fund balances	-	9,799	31,083
Fund balances at beginning of year (as restated)	<u>1,500</u>	<u>77,924</u>	<u>152,926</u>
<b>Fund balances at end of year</b>	<u>\$ 1,500</u>	<u>\$ 87,723</u>	<u>\$ 184,009</u>

(concluded)

The accompanying notes are an integral part of this statement.

## **GENERAL FUND**

The General Fund is a constitutional fund and is utilized to account for all City revenues and expenditures except those which are required to be classed in other funds and such other funds that are presented separately to facilitate proper accountability.

**CITY OF PALACIOS, TEXAS***MAJOR GOVERNMENTAL FUNDS - GENERAL FUND**BALANCE SHEET**September 30, 2016**With comparative totals for September 30, 2015*

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	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 783,739	\$ 669,789
Receivables (net)		
Accounts	24,687	26,007
Taxes	286,015	351,994
Fines	84,746	78,702
Due from other governments	111,640	88,241
Due from other funds	88,290	78,000
Inventory	12,667	7,934
<b>Total assets</b>	<u>\$ 1,391,784</u>	<u>\$ 1,300,667</u>
<b>LIABILITIES AND FUND BALANCES</b>		
Liabilities		
Accounts payable	\$ 24,483	\$ 24,532
Accrued expenses	44,959	27,529
Due to other funds	238	238
Due to other governments	12,224	13,422
<b>Total liabilities</b>	<u>81,904</u>	<u>65,721</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unearned revenues	372,384	432,193
<b>Total Deferred Inflows of Resources</b>	<u>372,384</u>	<u>432,193</u>
Fund balances		
Nonspendable	12,667	7,934
Unassigned	924,829	794,819
<b>Total fund balances</b>	<u>937,496</u>	<u>802,753</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,391,784</u>	<u>\$ 1,300,667</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance Positive (Negative)	2015
	Original Budget	Final Budget	Actual		Actual
<b>REVENUES</b>					
Ad valorem taxes					
Current and delinquent taxes	\$ 1,400,300	\$ 1,457,951	\$ 1,463,392	\$ 5,441	\$ 1,321,303
Penalty and interest	50,000	100,000	102,275	2,275	50,607
Tax certificates, other fees	3,000	3,000	2,590	(410)	505
Total ad valorem taxes	<u>1,453,300</u>	<u>1,560,951</u>	<u>1,568,257</u>	<u>7,306</u>	<u>1,372,415</u>
Other taxes					
Sales tax	300,000	324,000	327,376	3,376	311,937
Property tax reduction sales tax	150,000	162,000	163,688	1,688	155,951
Franchise tax	145,000	145,000	146,546	1,546	155,123
Bingo tax	100	100	78	(22)	-
Mixed beverage tax	6,500	6,500	5,988	(512)	5,319
Total other taxes	<u>601,600</u>	<u>637,600</u>	<u>643,676</u>	<u>6,076</u>	<u>628,330</u>
Licenses and permits					
Building and moving permits	16,300	16,300	23,386	7,086	16,582
Dog licenses	11,300	11,300	8,100	(3,200)	16,015
Total licenses and permits	<u>27,600</u>	<u>27,600</u>	<u>31,486</u>	<u>3,886</u>	<u>32,597</u>
Intergovernmental					
Grant proceeds	-	54,290	51,089	(3,201)	1,276
Charges for services					
Weedy lot mowing	-	-	-	-	-
Economic development	-	-	-	-	-
Total charges for services	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fines and forfeitures					
Fines and court costs	75,000	88,200	92,385	4,185	94,744
Investment income					
Interest	1,500	1,500	2,686	1,186	969
Miscellaneous					
Insurance reimbursement	20,000	29,400	29,439	39	87,056
Maintenance contract	50,000	50,000	50,000	-	50,000
Other	43,400	68,400	73,850	5,450	61,268
Total miscellaneous	<u>113,400</u>	<u>147,800</u>	<u>153,289</u>	<u>5,489</u>	<u>198,324</u>
<b>Total revenues</b>	<u>2,272,400</u>	<u>2,517,941</u>	<u>2,542,868</u>	<u>24,927</u>	<u>2,328,655</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance Positive (Negative)	2015
	Original Budget	Final Budget	Actual		Actual
<b>EXPENDITURES</b>					
<b>General government</b>					
Mayor and city council					
Salaries and wages	\$ 20,400	\$ 20,400	\$ 20,200	\$ 200	\$ 20,600
Office supplies	1,400	1,400	1,262	138	1,393
Special services	1,800	1,800	55	1,745	848
Travel, training, and dues	3,200	3,200	3,137	63	3,936
Social security tax	1,650	1,650	1,637	13	1,668
Employee benefits	100	100	55	45	53
Capital outlay	-	-	-	-	-
Total mayor and city council	<u>28,550</u>	<u>28,550</u>	<u>26,346</u>	<u>2,204</u>	<u>28,498</u>
Elections					
Office supplies	1,500	1,500	70	1,430	-
Special services	<u>800</u>	<u>800</u>	-	<u>800</u>	-
Total elections	<u>2,300</u>	<u>2,300</u>	<u>70</u>	<u>2,230</u>	-
Administrative					
Salaries and wages	298,900	298,900	289,563	9,337	238,809
Office supplies	8,500	8,500	7,584	916	8,638
Maintenance - office equipment	30,250	31,120	28,625	2,495	23,868
Maintenance - buildings	3,000	3,000	1,065	1,935	38,242
Telephone	5,500	5,700	5,726	(26)	5,631
Electricity	3,300	3,400	3,317	83	3,684
Gas	480	480	440	40	470
Professional fees	39,750	40,275	33,857	6,418	39,537
Special services	10,000	10,000	6,499	3,501	21,460
Travel, training, and dues	11,500	6,100	4,876	1,224	8,805
Social security tax	22,500	22,500	21,570	930	18,145
Employee benefits	110,400	96,400	93,165	3,235	82,062
Capital outlay	-	<u>19,000</u>	<u>19,000</u>	-	<u>10,000</u>
Total administrative	<u>544,080</u>	<u>545,375</u>	<u>515,287</u>	<u>30,088</u>	<u>499,351</u>
Legal					
Special services	<u>8,000</u>	<u>8,000</u>	<u>1,733</u>	<u>6,267</u>	<u>2,543</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance Positive (Negative)	2015
	Original Budget	Final Budget	Actual		Actual
<b>General government - (continued)</b>					
Corporation court					
Salaries and wages	\$ 66,680	\$ 68,980	\$ 68,751	\$ 229	\$ 67,364
Office supplies	300	400	392	8	185
Maintenance - office equipment	5,000	5,315	5,314	1	6,227
Telephone	80	80	83	(3)	99
Special services	500	500	216	284	222
Travel, training, and dues	2,000	2,000	1,937	63	1,967
Social security tax	5,000	5,175	5,168	7	5,109
Employee benefits	13,600	13,875	13,815	60	13,569
Capital outlay	-	-	-	-	-
Total corporation court	<u>93,160</u>	<u>96,325</u>	<u>95,676</u>	<u>649</u>	<u>94,742</u>
Library					
Special services	<u>30,000</u>	<u>30,000</u>	<u>30,000</u>	<u>-</u>	<u>30,000</u>
Total general government	<u>706,090</u>	<u>710,550</u>	<u>669,112</u>	<u>41,438</u>	<u>655,134</u>
<b>Public safety</b>					
Police department					
Salaries and wages	727,600	753,030	752,944	86	795,134
Minor tools	5,000	4,600	4,604	(4)	6,067
Office supplies	5,000	3,000	2,884	116	5,768
Clothing	3,000	1,800	1,330	470	3,732
Maintenance - buildings	800	-	-	-	212
Maintenance - radios/radar	28,400	32,910	32,709	201	31,803
Maintenance - office equipment	7,400	5,900	5,543	357	7,310
Telephone, electricity, and gas	14,880	16,880	16,831	49	15,980
Special services	2,100	7,100	6,993	107	4,922
Travel, training, and dues	6,900	5,900	4,582	1,318	5,044
Support of prisoners	500	500	262	238	277
Social security tax	55,000	55,750	55,748	2	60,571
Employee benefits	247,000	232,200	231,146	1,054	236,936
Capital outlay	-	-	-	-	-
Total police department	<u>1,103,580</u>	<u>1,119,570</u>	<u>1,115,576</u>	<u>3,994</u>	<u>1,173,756</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance Positive (Negative)	2015
	Original	Final	Actual		Actual
	Budget	Budget			
<b>Public safety - (continued)</b>					
Fire department					
Supplies	\$ 6,000	\$ 12,420	\$ 10,341	\$ 2,079	\$ 935
Chemicals	200	200	-	200	-
Maintenance - equipment	500	500	3,935	(3,435)	-
Maintenance - buildings	1,000	-	-	-	-
Maintenance - radios	-	-	-	-	-
Telephone	1,100	1,100	1,206	(106)	1,346
Electricity	1,500	1,500	1,353	147	1,470
Gas	400	400	426	(26)	373
Travel, training, and dues	800	800	-	800	-
Special services	3,200	11,400	11,016	384	1,540
Employee benefits	20,600	20,600	22,543	(1,943)	19,864
Capital outlay	-	-	-	-	-
Total fire department	<u>35,300</u>	<u>48,920</u>	<u>50,820</u>	<u>(1,900)</u>	<u>25,528</u>
Total public safety	<u>1,138,880</u>	<u>1,168,490</u>	<u>1,166,396</u>	<u>2,094</u>	<u>1,199,284</u>
<b>Public works</b>					
Park maintenance					
Salaries	29,650	28,650	28,496	154	14,953
Tools and supplies	6,400	7,325	7,339	(14)	8,375
Chemicals	-	-	-	-	-
Reconstruction materials	23,000	36,906	35,660	1,246	25,792
Electricity	18,000	7,500	7,366	134	12,334
Special services	67,000	76,100	77,270	(1,170)	82,060
Employee Benefit	16,430	13,550	13,358	192	8,628
Capital outlay	-	27,500	27,435	65	-
Total park maintenance	<u>160,480</u>	<u>197,531</u>	<u>196,924</u>	<u>607</u>	<u>152,142</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance	2015
	Original Budget	Final Budget	Actual	Positive (Negative)	Actual
<b>EXPENDITURES - (CONTINUED)</b>					
<b>Public works - (continued)</b>					
Streets					
Salaries and wages	\$ 29,650	\$ 21,950	\$ 21,564	\$ 386	\$ 14,975
Tools and supplies	3,000	2,500	(2,863)	5,363	4,786
Chemicals	2,500	500	419	81	2,904
Clothing	-	-	-	-	-
Maintenance - radios	100	100	-	100	-
Reconstruction materials	17,500	59,600	59,518	82	30,733
Pipe and culverts	10,000	10,000	9,315	685	5,305
Electricity	40,000	43,500	43,482	18	45,002
Special services	10,000	85,100	84,822	278	1,644
Social security tax	2,230	2,230	1,540	690	1,146
Employee benefits	11,900	8,700	8,649	51	6,101
Capital outlay	50,000	50,000	-	50,000	-
Total streets	<u>176,880</u>	<u>284,180</u>	<u>226,446</u>	<u>57,734</u>	<u>112,596</u>
Total public works	<u>337,360</u>	<u>481,711</u>	<u>423,370</u>	<u>58,341</u>	<u>264,738</u>
<b>Health and welfare</b>					
Animal control					
Supplies	3,900	2,850	1,752	1,098	1,326
Telephone	800	870	879	(9)	771
Electricity	1,200	1,450	1,448	2	1,346
Special services	1,000	1,725	1,690	35	2,195
Travel, training, and dues	500	500	104	396	50
Capital outlay	-	-	-	-	-
Total animal control	<u>7,400</u>	<u>7,395</u>	<u>5,873</u>	<u>1,522</u>	<u>5,688</u>
Recycling center					
Salaries and wages	8,800	8,885	8,884	1	9,180
Tools and supplies	1,400	1,440	1,432	8	1,469
Telephone	700	700	699	1	783
Electricity	800	1,050	1,047	3	904
Special services	620	1,795	1,863	(68)	1,441
Travel, training, and dues	750	175	171	4	837
Social security tax	700	700	666	34	692
Employee benefits	1,500	1,510	1,508	2	1,577
	-	-	-	-	-
Total recycling center	<u>15,270</u>	<u>16,255</u>	<u>16,270</u>	<u>(15)</u>	<u>16,883</u>
Total health and welfare	<u>22,670</u>	<u>23,650</u>	<u>22,143</u>	<u>1,507</u>	<u>22,571</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2016

With comparative totals for the year ended September 30, 2015

	2016			Variance Positive (Negative)	2015
	Original Budget	Final Budget	Actual		Actual
<b>Special services</b>					
Unemployment	\$ 4,000	\$ 6,150	\$ 6,128	\$ 22	\$ 1,323
Note principal	-	-	-	-	-
Boys & Girls Club	-	44,190	44,190	-	-
Hospital assistance	10,000	10,000	10,000	-	10,000
Development agreement rebate	55,000	64,800	889	63,911	1,996
Insurance and bonds	74,000	84,000	83,927	73	85,322
Community improvements	1,000	1,000	560	440	2,535
Total special services	<u>144,000</u>	<u>210,140</u>	<u>145,694</u>	<u>64,446</u>	<u>101,176</u>
<b>Total expenditures</b>	<u>2,349,000</u>	<u>2,594,541</u>	<u>2,426,715</u>	<u>167,826</u>	<u>2,242,903</u>
Excess (deficiency) of revenues over expenditures	(76,600)	(76,600)	116,153	192,753	85,752
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers in	158,600	158,600	158,600	-	158,600
Transfers out	<u>(82,000)</u>	<u>(82,000)</u>	<u>(141,783)</u>	<u>(59,783)</u>	<u>(148,356)</u>
<b>Total other financing sources (uses)</b>	<u>76,600</u>	<u>76,600</u>	<u>16,817</u>	<u>(59,783)</u>	<u>10,244</u>
Net change in fund balance	-	-	132,970	132,970	95,996
Fund balance at beginning of year	<u>804,526</u>	<u>804,526</u>	<u>804,526</u>	-	<u>804,526</u>
<b>Fund balance at end of year</b>	<u>\$ 804,526</u>	<u>\$ 804,526</u>	<u>\$ 937,496</u>	<u>\$ 132,970</u>	<u>\$ 900,522</u>

(concluded)

The accompanying notes are an integral part of this statement.

## **ENTERPRISE FUNDS**

Enterprise funds account for the acquisition, operations and maintenance of the City's facilities and services which are entirely or predominantly supported by user charges or those for which the City has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. All activities necessary to provide services are accounted for in these funds, including, but not limited to, administration, operations, and maintenance. Debt service amounts are also included.

**Water and Sewer Fund** – Records transactions relative to the provision of water and wastewater services to the residents of the City.

**Airport Fund** – Records transactions relative to the operation of the City's Airport.

**CITY OF PALACIOS, TEXAS***MAJOR ENTERPRISE FUND - WATER AND SEWER FUND**STATEMENT OF NET POSITION**September 30, 2016**With comparative totals for September 30, 2015*

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 376,492	\$ 379,775
Receivables		
Accounts	477,890	475,379
Other	678	943
Allowance for uncollectible accounts	(166,617)	(165,846)
Due from other funds	-	-
Inventory	<u>52,823</u>	<u>48,517</u>
Total current assets	<u>741,266</u>	<u>738,768</u>
Noncurrent assets		
Capital assets		
Office equipment and furniture	47,715	47,715
Machinery and equipment	940,402	940,402
Service delivery system	22,969,507	22,934,565
Buildings and fixtures	3,404,639	3,404,639
Land structured facilities	<u>760,184</u>	<u>760,184</u>
Total capital assets	28,122,447	28,087,505
Accumulated depreciation	<u>(10,616,001)</u>	<u>(9,905,311)</u>
Subtotal	17,506,446	18,182,194
Land	8,129	8,129
Construction in progress	<u>52,200</u>	<u>-</u>
Net capital assets	<u>17,566,775</u>	<u>18,190,323</u>
Deferred expenses (net)	<u>26,913</u>	<u>39,952</u>
Total noncurrent capital assets	<u>17,593,688</u>	<u>18,230,275</u>
<b>Total assets</b>	<u>18,334,954</u>	<u>18,969,043</u>
 <b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Contributions after 12/31/15 through 9/30/16	<u>98,062</u>	<u>52,917</u>
Total Deferred Outflows of Resources	<u>98,062</u>	<u>52,917</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

*MAJOR ENTERPRISE FUND - WATER AND SEWER FUND*

*STATEMENT OF NET POSITION*

*September 30 2016*

*With comparative totals for September 30, 2015*

**LIABILITIES**

Current liabilities

Accounts payable	74,308	71,039
Accrued expenses	7,714	9,209
Due to other funds	46,723	46,723
Accrued interest payable	14,781	15,475
Customer meter deposits	119,688	118,488
Accrued compensated absences	12,591	9,746
Current portion of payable to developer	50,000	50,000
Current portion of general obligation bonds	190,000	185,000
Current portion of notes	88,234	88,234

Total current liabilities	<u>604,039</u>	<u>593,914</u>
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Noncurrent liabilities

Net Pension Liability	397,858	335,868
Notes payable	264,702	352,935
General obligation bonds	-	-
Certificates of obligation	2,845,000	3,035,000
Payable to developer	866,048	925,831

Total noncurrent liabilities	<u>4,373,608</u>	<u>4,649,634</u>
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<b>Total liabilities</b>	<u>4,977,647</u>	<u>5,243,548</u>
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**DEFERRED INFLOWS OF RESOOURCES**

Actual expense vs. assumptions	<u>28,382</u>	<u>38,254</u>
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Total Deferred inflows of Resources	<u>28,382</u>	<u>38,254</u>
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**NET POSITION**

Invested in capital assets, net of related debt	13,274,923	13,577,800
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Unrestricted	<u>152,064</u>	<u>162,358</u>
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<b>Total net position</b>	<u>\$ 13,426,987</u>	<u>\$ 13,740,158</u>
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The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS***MAJOR ENTERPRISE FUND - WATER AND SEWER FUND**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**For the year ended September 30, 2016**With comparative totals for the year ended September 30, 2015*

	<u>2016</u>	<u>2015</u>
<b>OPERATING REVENUES</b>		
Charges for services	\$ 1,704,600	\$ 1,718,047
<b>OPERATING EXPENSES</b>		
Water system	704,706	579,379
Sanitary sewer system	295,829	303,903
Solid waste	-	-
Miscellaneous	24,519	26,163
Depreciation	710,689	715,679
Amortization	-	-
<b>Total operating expenses</b>	<u>1,735,743</u>	<u>1,625,124</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	(31,143)	92,923
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income		
Interest	965	861
Connection fees	19,473	8,750
Miscellaneous income (expense)	1,356	2,047
Interest and fiscal charges	<u>(136,146)</u>	<u>(133,515)</u>
<b>Total nonoperating revenues (expenses)</b>	<u>(114,352)</u>	<u>(121,857)</u>
Income (loss) before contributions and transfers	(145,495)	(28,934)
Contributions and transfers		
Capital contributions	52,200	63,516
Transfers out	(275,600)	(285,600)
Transfers in	<u>59,783</u>	<u>76,356</u>
Total contributions and transfers	<u>(163,617)</u>	<u>(145,728)</u>
Change in net position	(309,112)	(174,662)
Total net position at beginning of year	<u>13,736,099</u>	<u>13,914,820</u>
<b>Total net position at end of year</b>	<u>\$ 13,426,987</u>	<u>\$ 13,740,158</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS****MAJOR ENTERPRISE FUND - AIRPORT FUND****STATEMENT OF NET POSITION**

September 30, 2016

With comparative totals for September 30, 2015

	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	300	1,225
Inventory	<u>9,120</u>	<u>15,776</u>
Total current assets	<u>9,420</u>	<u>17,001</u>
Noncurrent assets		
Capital assets		
Machinery and equipment	85,462	85,462
Buildings and fixtures	66,479	66,479
Land structured facilities	<u>1,581,337</u>	<u>1,581,337</u>
Total capital assets	1,733,278	1,733,278
Accumulated depreciation	<u>(523,869)</u>	<u>(477,720)</u>
Subtotal	<u>1,209,409</u>	<u>1,255,558</u>
Construction in progress	<u>-</u>	<u>-</u>
Net capital assets	<u>1,209,409</u>	<u>1,255,558</u>
<b>Total assets</b>	<u>1,218,829</u>	<u>1,272,559</u>
<b>LIABILITIES</b>		
Accounts payable	853	477
Due to other funds	<u>1,196</u>	<u>12,650</u>
<b>Total liabilities</b>	<u>2,049</u>	<u>13,127</u>
<b>NET POSITION</b>		
Invested in capital assets	1,209,409	1,255,558
Unrestricted	<u>7,371</u>	<u>3,874</u>
<b>Total net position</b>	<u>\$ 1,216,780</u>	<u>\$ 1,259,432</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS***MAJOR ENTERPRISE FUND - AIRPORT FUND**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**For the year ended September 30, 2016**With comparative totals for the year ended September 30, 2015*

	<u>2016</u>	<u>2015</u>
<b>OPERATING REVENUES</b>		
Charges for services	\$ 12,448	\$ 28,236
Rental income	<u>14,177</u>	<u>12,102</u>
<b>Total operating revenues</b>	<u>26,625</u>	<u>40,338</u>
<b>OPERATING EXPENSES</b>		
Airport expenses		
Supplies	13,850	38,273
Repairs and maintenance	3,980	300
Utilities	5,616	8,018
Insurance and bonds	18,165	14,549
Special items	12,372	21,936
Depreciation	<u>46,149</u>	<u>46,149</u>
<b>Total operating expenses</b>	<u>100,132</u>	<u>129,225</u>
Operating income (loss) before nonoperating revenues (expenses) and transfers	(73,507)	(88,887)
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income		
Interest	13	11
Miscellaneous income (expense)	7,105	6,961
Nonoperating lease income	<u>23,737</u>	<u>23,737</u>
<b>Total nonoperating revenues (expenses)</b>	<u>30,855</u>	<u>30,709</u>
Income (loss) before transfers	(42,652)	(58,178)
Transfers		
Transfer out	<u>-</u>	<u>-</u>
Total transfers	<u>-</u>	<u>-</u>
Change in net position	(42,652)	(58,178)
Total net position at beginning of year	<u>1,259,432</u>	<u>1,317,610</u>
<b>Total net position at end of year</b>	<u>\$ 1,216,780</u>	<u>\$ 1,259,432</u>

The accompanying notes are an integral part of this statement.

## **OVERALL COMPLIANCE AND INTERNAL CONTROL SECTION**

***Baker, Stogner & Associates***  
*Certified Public Accountants*

316 E. Jackson  
El Campo, TX 77437

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(979) 543-6668 Fax

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the City Council  
City of Palacios, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the City of Palacios, Texas' basic financial statements, and have issued our report thereon dated February 14, 2017.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the City of Palacios, Texas' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Palacios, Texas' internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Palacios, Texas' internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the City of Palacios, Texas' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Baker, Stogner & Associates*

El Campo, Texas

February 14, 2017