

CITY OF PALACIOS, TEXAS

ANNUAL FINANCIAL REPORT

For the year ended September 30, 2010

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INTRODUCTORY SECTION

CITY OF PALACIOS, TEXAS
DIRECTORY OF PRINCIPAL OFFICIALS
September 30, 2010

City Officials

Joseph Morton

Ed Schulze

Andy Erdelt

Mike Witte

Bert West

Gary Hafernick

Troy Lewis

Elective Position

Mayor

Mayor Pro-Tem

Council Member

Council Member

Council Member

Council Member

Council Member

Key Staff

Charles R. Winfield

Randall B. Strong

Linh Chau

Keri Berger

Irma De Leon

Appointive Position

City Manager

City Attorney

Municipal Court Judge

City Secretary

City Treasurer

FINANCIAL SECTION



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INDEPENDENT AUDITORS' REPORT

The Honorable Mayor and Members
of City Council
City of Palacios, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, and each major fund of the City of Palacios, Texas (the "City"), as of and for the year ended September 30, 2010, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 unit, and each major fund of the City as of September 30, 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 19, 2011, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 10 and 44 through 45 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

The Honorable Mayor and Members
of City Council

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.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, combining and individual major and nonmajor fund financial statements, and schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual major and nonmajor fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken 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 express no opinion on it.

Harrison Waldrop + Uherok, LLP

January 19, 2011

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, 2010.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$16,117,550 (*net assets*). Of this amount, \$1,254,040 (*unrestricted net assets*) 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 \$447,328, an increase of \$28,925 from the prior year. At the end of the current fiscal year, unreserved fund balance for the General Fund was \$367,815, or 15.63% of total General Fund expenditures.
- The City's total debt of business-type activities increased by \$1,122,596 or 161.06% during the fiscal year, ending with a balance of \$1,819,617 of which \$218,652 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 4 to 10

Government-wide Financial Statements

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

Pages 11 to 14

Fund Financial Statements

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

Pages 15 to 23

Notes to Financial Statements

Provides a summary of significant accounting policies and related disclosures.

Pages 25 to 43

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 Assets

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets 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 assets changed during the most recent fiscal year. All changes in net assets 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 twelve individual governmental funds during the 2009-2010 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 eleven 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 assets may serve over time as a useful indicator of a government's financial position. In the case of the City, net assets exceeded liabilities by \$16,117,550 at the close of the fiscal year 2010.

By far, the largest portion of the City's net assets (92.22%) 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)

City of Palacios, Texas

Net Assets

	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
Current and other assets	\$ 939,102	\$ 936,120	\$ 633,634	\$ 832,863	\$ 1,572,736	\$ 1,768,983
Capital assets (net)	1,731,607	1,848,369	15,139,568	4,870,450	16,871,175	6,718,819
Other noncurrent assets	8,570	10,285	40,992	51,241	49,562	61,526
Total assets	<u>2,679,279</u>	<u>2,794,774</u>	<u>15,814,194</u>	<u>5,754,554</u>	<u>18,493,473</u>	<u>8,549,328</u>
Current liabilities	179,373	186,457	434,685	354,650	614,058	541,107
Noncurrent liabilities	160,900	196,700	1,600,965	560,000	1,761,865	756,700
Total liabilities	<u>340,273</u>	<u>383,157</u>	<u>2,035,650</u>	<u>914,650</u>	<u>2,375,923</u>	<u>1,297,807</u>
Invested in capital assets, net of related debt	1,534,907	1,627,854	13,328,603	4,231,691	14,863,510	5,859,545
Unrestricted	804,099	783,763	449,941	608,213	1,254,040	1,391,976
Total net assets	<u>\$ 2,339,006</u>	<u>\$ 2,411,617</u>	<u>\$ 13,778,544</u>	<u>\$ 4,839,904</u>	<u>\$ 16,117,550</u>	<u>\$ 7,251,521</u>

The balance of unrestricted net assets, \$1,254,040, 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 assets for the primary government as a whole.

GOVERNMENT-WIDE FINANCIAL ANALYSIS - (Continued)

Governmental activities decreased the City's net assets by \$72,611. Business-type activities increased the City's net assets by \$8,938,640.

City of Palacios, Texas

Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
REVENUES						
Program revenues:						
Charges for services	\$ 100,523	\$ 76,918	\$ 1,949,320	\$ 1,940,715	\$ 2,049,843	\$ 2,017,633
Operating grants and contributions	55,506	28,709	-	-	55,506	28,709
Capital grants and contributions	-	62,389	9,399,438	157,252	9,399,438	219,641
General revenues:						
Property taxes	1,150,478	1,023,272	-	-	1,150,478	1,023,272
Sales taxes	391,631	381,716	-	-	391,631	381,716
Franchise taxes	146,694	145,482	-	-	146,694	145,482
Other taxes	23,228	32,637	-	-	23,228	32,637
Unrestricted investment earnings	2,361	6,995	2,674	7,936	5,035	14,931
Miscellaneous	183,110	256,999	47,584	71,511	230,694	328,510
Total revenues	2,053,531	2,015,117	11,399,016	2,177,414	13,452,547	4,192,531
EXPENSES						
General government	692,744	726,266	-	-	692,744	726,266
Public safety	1,148,741	1,046,553	-	-	1,148,741	1,046,553
Public works	565,798	710,680	-	-	565,798	710,680
Special services	180,850	156,161	-	-	180,850	156,161
Health and welfare	63,484	57,987	-	-	63,484	57,987
Interest on long-term debt	10,800	15,418	-	-	10,800	15,418
Water and sewer	-	-	1,820,662	1,536,431	1,820,662	1,536,431
Airport	-	-	103,439	91,793	103,439	91,793
Total expenses	2,662,417	2,713,065	1,924,101	1,628,224	4,586,518	4,341,289
Change in net assets before transfers	(608,886)	(697,948)	9,474,915	549,190	8,866,029	(148,758)
Transfers	536,275	707,838	(536,275)	(707,838)	-	-
Change in net assets	(72,611)	9,890	8,938,640	(158,648)	8,866,029	(148,758)
Net assets - beginning, as restated	2,411,617	2,401,727	4,839,904	4,998,552	7,251,521	7,400,279
Net assets - ending	\$ 2,339,006	\$ 2,411,617	\$ 13,778,544	\$ 4,839,904	\$ 16,117,550	\$ 7,251,521

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, unreserved 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 \$447,328, an increase of \$28,925 from the prior year.

Approximately 96.86% of this total amount, \$433,269 constitutes unreserved fund balance, which is available for spending at the City's discretion. The remainder of fund balance of \$14,059 or 3.14% is reserved to indicate that it is not available for new spending because it has already been committed for inventory.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance was \$367,815. Unreserved fund balance represents 15.62% of total General Fund expenditures.

The fund balance of the City's General Fund increased by \$60,468 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 assets of the Water and Sewer Fund at the end of the current fiscal year amounted to \$(970,858), which is a decrease of \$1,325,051 from the prior year. Unrestricted net assets of the Airport Fund amounted to \$128,842 at the end of the current fiscal year, which is a decrease of \$125,178 from the prior year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The City's investment in capital assets for its governmental and business-type activities amounts to \$16,871,175 (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 increase in the City's investment in capital assets was 151.10% (a 6.32% decrease for governmental activities and a 210.85% increase in business-type activities).

City of Palacios, Texas						
Capital Assets (Net of Depreciation)						
	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
Land	\$ 357,286	\$ 357,286	\$ 7,373	\$ 7,373	\$ 364,659	\$ 364,659
Construction in progress	-	-	94,354	-	94,354	-
Buildings and improvements	611,210	627,214	665,976	756,420	1,277,186	1,383,634
Machinery and equipment	416,355	483,997	3,453	7,181	419,808	491,178
Land structured facilities	346,756	379,872	365,504	389,809	712,260	769,681
Water and sewer system	-	-	14,002,908	3,709,667	14,002,908	3,709,667
Total	\$ 1,731,607	\$ 1,848,369	\$ 15,139,568	\$ 4,870,450	\$ 16,871,175	\$ 6,718,819

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 2010 fiscal year, the City did not incur any new debt issues. The City retired \$130,000 of the prior outstanding debt issue, the 2004 general obligation refunding bonds. The amount that is outstanding at year-end totals \$560,000. The City also retired \$34,100 of the tax notes issued in 2008 for the purchase of the new City Hall. The amount outstanding on the tax notes total \$196,700. The bonds mature in 2014 and the tax notes mature in 2015. 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 \$1,250,965.

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 2010-2011 fiscal year.

The total sales tax payments received by the City from the State Comptroller in fiscal year 2010 totaled \$389,557. This amount is an increase of \$10,455 or 2.05% over the previous year, indicating a fairly stable pattern (growing pattern) in the retail economy.

The certified assessed taxable property valuations for the 2010 tax roll total \$165,982,971 with a tax rate of \$0.813160 per \$100 valuation. The tax rate increased \$0.08599 over last year. \$0.782470 was allocated for maintenance and operations, and \$0.03069 was allocated for interest and sinking (debt service). The projected total property tax due is \$1,288,598 for the 2010 tax year.

Of the \$1,288,598 of projected 2010 property tax due, and using a 93% collection rate, \$113,189 is projected to be collected from the newly annexed Beachside subdivision. Of the \$113,189 projected collection, \$84,892 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, \$142,664.72 had been reimbursed leaving a balance of \$1,262,456.28.

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.

At the time of adoption of the 2010-2011 fiscal year budget, planning for the issuance of approximately \$3.5 million of Certificates of Obligation was under development and not included in the budget. The proceeds of these Certificates of Obligation are to be used to finance the construction of a new water well, ground storage tank, water main replacements, water tower rehabilitation, and necessary improvements at the wastewater treatment plant.

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.

CITY OF PALACIOS, TEXAS
STATEMENT OF NET ASSETS
September 30, 2010

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
ASSETS				
Current assets				
Cash and cash equivalents	\$ 264,178	\$ 427,551	\$ 691,729	\$ 163,821
Receivables (net)	469,988	240,352	710,340	2,850
Internal balances	107,016	(107,016)	-	-
Due from other governments	83,861	-	83,861	26,620
Inventory	14,059	72,747	86,806	-
Total current assets	<u>939,102</u>	<u>633,634</u>	<u>1,572,736</u>	<u>193,291</u>
Noncurrent assets				
Capital assets				
Land and other assets not being depreciated	357,286	101,727	459,013	-
Buildings, improvements, and equipment (net)	1,374,321	15,037,841	16,412,162	-
Deferred expenses (net)	8,570	40,992	49,562	-
Total noncurrent assets	<u>1,740,177</u>	<u>15,180,560</u>	<u>16,920,737</u>	<u>-</u>
Total assets	<u>2,679,279</u>	<u>15,814,194</u>	<u>18,493,473</u>	<u>193,291</u>

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
LIABILITIES				
Current liabilities				
Accounts payable	\$ 78,905	\$ 89,002	\$ 167,907	\$ 219
Accrued expenses	32,053	17,443	49,496	1,816
Accrued interest payable	-	1,508	1,508	-
Due to other governments	11,019	-	11,019	-
Customer meter deposits	-	108,080	108,080	-
Accrued compensated absences	21,596	8,652	30,248	67
Payable to developer	-	75,000	75,000	-
Current portion of long-term obligations	35,800	135,000	170,800	-
Total current liabilities	179,373	434,685	614,058	2,102
Noncurrent liabilities				
Noncurrent portion of long-term obligations	160,900	1,600,965	1,761,865	-
Total noncurrent liabilities	160,900	1,600,965	1,761,865	-
Total liabilities	340,273	2,035,650	2,375,923	2,102
NET ASSETS				
Invested in capital assets, net of related debt	1,534,907	13,328,603	14,863,510	-
Unrestricted net assets	804,099	449,941	1,254,040	191,189
Total net assets	\$ 2,339,006	\$ 13,778,544	\$ 16,117,550	\$ 191,189

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS
STATEMENT OF ACTIVITIES
For the year ended September 30, 2010

Function/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government				
Governmental activities				
General government	\$ 692,744	\$ 15,927	\$ 1,250	\$ -
Public safety	1,148,741	82,463	-	-
Public works	565,798	2,133	54,256	-
Special services	180,850	-	-	-
Health and welfare	63,484	-	-	-
Interest on long-term debt	10,800	-	-	-
Total governmental activities	<u>2,662,417</u>	<u>100,523</u>	<u>55,506</u>	<u>-</u>
Business-type activities				
Water and sewer	1,820,662	1,874,969	-	9,399,438
Airport	103,439	74,351	-	-
Total business-type activities	<u>1,924,101</u>	<u>1,949,320</u>	<u>-</u>	<u>9,399,438</u>
Total primary government	<u>\$ 4,586,518</u>	<u>\$ 2,049,843</u>	<u>\$ 55,506</u>	<u>\$ 9,399,438</u>
Component Unit				
Palacios Economic Development Corporation	<u>\$ 94,923</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

General revenues:

Taxes:

Property taxes, levied for general purposes

Sales taxes

Franchise taxes

Other taxes and fees

Unrestricted investment earnings

Miscellaneous

Transfers

Total general revenues and transfers

Change in net assets

Net assets - beginning

Net assets - ending

The accompanying notes are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Assets			Component Unit
Primary Government			
Governmental Activities	Business- type Activities	Total	Palacios Economic Development Corporation
\$ (675,567)	\$ -	\$ (675,567)	\$ -
(1,066,278)	-	(1,066,278)	-
(509,409)	-	(509,409)	-
(180,850)	-	(180,850)	-
(63,484)	-	(63,484)	-
(10,800)	-	(10,800)	-
<u>(2,506,388)</u>	<u>-</u>	<u>(2,506,388)</u>	<u>-</u>
-	9,453,745	9,453,745	-
<u>-</u>	<u>(29,088)</u>	<u>(29,088)</u>	<u>-</u>
-	9,424,657	9,424,657	-
<u>(2,506,388)</u>	<u>9,424,657</u>	<u>6,918,269</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>(94,923)</u>
1,150,478	-	1,150,478	-
391,631	-	391,631	130,544
146,694	-	146,694	-
23,228	-	23,228	-
2,361	2,674	5,035	974
183,110	47,584	230,694	10,650
<u>536,275</u>	<u>(536,275)</u>	<u>-</u>	<u>-</u>
<u>2,433,777</u>	<u>(486,017)</u>	<u>1,947,760</u>	<u>142,168</u>
(72,611)	8,938,640	8,866,029	47,245
<u>2,411,617</u>	<u>4,839,904</u>	<u>7,251,521</u>	<u>143,944</u>
<u>\$ 2,339,006</u>	<u>\$ 13,778,544</u>	<u>\$ 16,117,550</u>	<u>\$ 191,189</u>

CITY OF PALACIOS, TEXAS*BALANCE SHEET**GOVERNMENTAL FUNDS**September 30, 2010*

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS			
Current assets			
Cash and cash equivalents	\$ 190,301	\$ 73,877	\$ 264,178
Receivables (net)	466,177	3,811	469,988
Due from other governments	83,861	-	83,861
Due from other funds	189,335	4,025	193,360
Inventory	<u>14,059</u>	<u>-</u>	<u>14,059</u>
Total assets	<u>943,733</u>	<u>81,713</u>	<u>1,025,446</u>
LIABILITIES AND FUND BALANCES			
Liabilities			
Accounts payable	67,656	-	67,656
Accrued expenditures	32,053	-	32,053
Due to other funds	4,025	10,658	14,683
Due to other governments	5,418	5,601	11,019
Deferred revenue	<u>452,707</u>	<u>-</u>	<u>452,707</u>
Total liabilities	<u>561,859</u>	<u>16,259</u>	<u>578,118</u>
Fund balances			
Reserved for inventory	14,059	-	14,059
Unreserved, undesignated reported in:			
General fund	367,815	-	367,815
Special revenue funds	<u>-</u>	<u>65,454</u>	<u>65,454</u>
Total fund balances	<u>381,874</u>	<u>65,454</u>	<u>447,328</u>
Total liabilities and fund balances	<u>\$ 943,733</u>	<u>\$ 81,713</u>	<u>\$ 1,025,446</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

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

September 30, 2010

Total governmental fund balances	\$ 447,328
<i>Amounts reported for governmental activities in the statement of net assets 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 assets.	79,148
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, and therefore are deferred in the funds.	452,707
Capital assets used in governmental activities are reported as expenditures in governmental funds when purchased or constructed. The cost of these assets is \$6,192,034 and the accumulated depreciation is \$4,622,485.	1,569,549
Other noncurrent assets (for example, debt issuance costs) used in governmental activities are not financial resources, and therefore are not reported in governmental funds. The cost of these assets is \$12,000 and the accumulated amortization is \$3,430.	8,570
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:	
Tax notes payable	\$ (196,700)
Compensated absences	<u>(21,596)</u>
	<u>(218,296)</u>
Net assets of governmental activities	<u>\$ 2,339,006</u>

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, 2010

	General	Other Governmental Funds	Total Governmental Funds
REVENUES			
Taxes	\$ 1,754,662	\$ 15,259	\$ 1,769,921
Licenses and permits	15,927	-	15,927
Intergovernmental	1,250	4,256	5,506
Charges for services	1,942	-	1,942
Fines and forfeitures	72,722	4,156	76,878
Investment income	2,070	278	2,348
Miscellaneous	149,000	32,140	181,140
Total revenues	<u>1,997,573</u>	<u>56,089</u>	<u>2,053,662</u>
EXPENDITURES			
Current			
General government	616,506	14,000	630,506
Public safety	1,008,667	210	1,008,877
Public works	452,328	13,342	465,670
Special services	180,850	-	180,850
Health and welfare	51,893	-	51,893
Debt service			
Principal retirement	34,100	-	34,100
Interest and fiscal charges	9,085	-	9,085
Total expenditures	<u>2,353,429</u>	<u>27,552</u>	<u>2,380,981</u>
Excess (deficiency) of revenues over expenditures	(355,856)	28,537	(327,319)
OTHER FINANCING SOURCES (USES)			
Transfers in	457,893	-	457,893
Transfers out	(41,569)	(60,080)	(101,649)
Total other financing sources (uses)	<u>416,324</u>	<u>(60,080)</u>	<u>356,244</u>
Net change in fund balances	60,468	(31,543)	28,925
Fund balances at beginning of year	321,406	96,997	418,403
Fund balances at end of year	<u>\$ 381,874</u>	<u>\$ 65,454</u>	<u>\$ 447,328</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

*RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES
For the year ended September 30, 2010*

Total net change in fund balances - governmental funds	\$ 28,925
<i>Amounts reported for governmental activities in the statement of activities 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 net loss of the Internal Service Fund is reported with governmental activities.	(50,384)
Current year capital outlays are expenditures in the fund financial statements, but they should be shown as increases in capital assets in the government-wide financial statements. The net effect of removing the 2009/2010 capital outlays is to increase net assets.	9,009
Depreciation is not recognized as an expense on the governmental funds since it does not require the use of current financial resources. The net effect of the current year's depreciation is to decrease net assets.	(89,197)
Current year proceeds and payments on long-term debt are other financing sources and expenditures in the fund financial statements, but they serve to increase or reduce long-term liabilities in the government-wide financial statements. In the current year, these amounts consist of:	
Note principal retirement	34,100
Because some property taxes will not be collected for several months after the City's fiscal year ends, they are not considered "available" revenues and are deferred in the governmental funds. Similarly, other revenues are not currently available at year-end and are not reported as revenue in the governmental funds.	(144)
Some items reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:	
Decrease in debt issue costs	\$ (1,715)
Increase in compensated absences	(3,205) <u>(4,920)</u>
Change in net assets of governmental activities	\$ <u>(72,611)</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
September 30, 2010

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
ASSETS				
Current assets				
Cash and cash equivalents	\$ 311,425	\$ 116,126	\$ 427,551	\$ -
Receivables (net)	239,902	450	240,352	-
Due from other funds	10,658	-	10,658	-
Inventory	48,098	24,649	72,747	-
Total current assets	<u>610,083</u>	<u>141,225</u>	<u>751,308</u>	<u>-</u>
Noncurrent assets				
Land and other assets not being depreciated	7,373	94,354	101,727	-
Buildings, improvements, and equipment (net)	14,759,160	278,681	15,037,841	162,058
Deferred expenses (net)	40,992	-	40,992	-
Total noncurrent assets	<u>14,807,525</u>	<u>373,035</u>	<u>15,180,560</u>	<u>162,058</u>
Total assets	<u>15,417,608</u>	<u>514,260</u>	<u>15,931,868</u>	<u>162,058</u>
LIABILITIES				
Current liabilities				
Accounts payable	76,619	12,383	89,002	11,249
Accrued expenses	17,443	-	17,443	-
Due to other funds	117,674	-	117,674	71,661
Accrued interest payable	1,508	-	1,508	-
Customer meter deposits	108,080	-	108,080	-
Accrued compensated absences	8,652	-	8,652	-
Current portion of payable to developer	75,000	-	75,000	-
Current portion of general obligation bonds	135,000	-	135,000	-
Total current liabilities	<u>539,976</u>	<u>12,383</u>	<u>552,359</u>	<u>82,910</u>
Noncurrent liabilities				
General obligation bonds	425,000	-	425,000	-
Payable to developer	1,175,965	-	1,175,965	-
Total noncurrent liabilities	<u>1,600,965</u>	<u>-</u>	<u>1,600,965</u>	<u>-</u>
Total liabilities	<u>2,140,941</u>	<u>12,383</u>	<u>2,153,324</u>	<u>82,910</u>
NET ASSETS				
Invested in capital assets, net of related debt	14,247,525	373,035	14,620,560	162,058
Unrestricted net assets	(970,858)	128,842	(842,016)	(82,910)
Total net assets	<u>\$ 13,276,667</u>	<u>\$ 501,877</u>	<u>\$ 13,778,544</u>	<u>\$ 79,148</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

*STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS*

For the year ended September 30, 2010

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
OPERATING REVENUES				
Charges for services	\$ 1,874,969	\$ 42,006	\$ 1,916,975	\$ -
Rents	-	32,345	32,345	-
Total operating revenues	<u>1,874,969</u>	<u>74,351</u>	<u>1,949,320</u>	<u>-</u>
OPERATING EXPENSES				
Water system	539,276	-	539,276	-
Sanitary sewer system	228,379	-	228,379	-
Solid waste	545,720	-	545,720	-
Airport expenses	-	87,438	87,438	-
Miscellaneous	16,211	-	16,211	-
Equipment expenses	-	-	-	169,990
Depreciation and amortization	464,150	16,001	480,151	60,438
Total operating expenses	<u>1,793,736</u>	<u>103,439</u>	<u>1,897,175</u>	<u>230,428</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	81,233	(29,088)	52,145	(230,428)
NONOPERATING REVENUES (EXPENSES)				
Investment income	1,895	779	2,674	13
Connection fees	4,800	-	4,800	-
Miscellaneous income	8,705	11,904	20,609	-
Nonoperating lease income	-	22,175	22,175	-
Interest and fiscal charges	(26,926)	-	(26,926)	-
Total nonoperating revenues (expenses)	<u>(11,526)</u>	<u>34,858</u>	<u>23,332</u>	<u>13</u>
Income (loss) before contributions and transfers	69,707	5,770	75,477	(230,415)
Contributions and transfers				
Capital contributions	9,399,438	-	9,399,438	-
Transfers in	-	-	-	180,031
Transfers out	(483,680)	(52,595)	(536,275)	-
Total contributions and transfers	<u>8,915,758</u>	<u>(52,595)</u>	<u>8,863,163</u>	<u>180,031</u>
Change in net assets	8,985,465	(46,825)	8,938,640	(50,384)
Total net assets at beginning of year	<u>4,291,202</u>	<u>548,702</u>	<u>4,839,904</u>	<u>129,532</u>
Total net assets at end of year	<u>\$ 13,276,667</u>	<u>\$ 501,877</u>	<u>\$ 13,778,544</u>	<u>\$ 79,148</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, 2010

	<u>Business-type Activities</u>			Governmental Activities- Internal Service Fund
	<u>Water and Sewer</u>	<u>Airport</u>	<u>Total</u>	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers	\$ 1,897,635	\$ 74,328	\$ 1,971,963	\$ -
Cash paid to suppliers for goods and services	(1,081,481)	(96,409)	(1,177,890)	(170,908)
Cash paid to employees for services	(265,032)	-	(265,032)	-
Net cash provided (used) by operating activities	<u>551,122</u>	<u>(22,081)</u>	<u>529,041</u>	<u>(170,908)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Transfers (to) from other funds	(483,680)	(52,595)	(536,275)	180,031
Borrowings (repayments) to other funds	38,006	-	38,006	559
Connection fees	4,800	-	4,800	-
Miscellaneous income (expense)	8,705	34,079	42,784	-
Increase (decrease) in customer meter deposits	2,077	-	2,077	-
Net cash provided (used) by noncapital financing activities	<u>(430,092)</u>	<u>(18,516)</u>	<u>(448,608)</u>	<u>180,590</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition and construction of capital assets	-	(84,813)	(84,813)	(23,864)
Principal paid on long-term debt	(130,000)	-	(130,000)	-
Interest paid	(22,566)	-	(22,566)	-
Net cash provided (used) by capital and related financing activities	<u>(152,566)</u>	<u>(84,813)</u>	<u>(237,379)</u>	<u>(23,864)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment income	1,895	779	2,674	13
Net cash provided (used) by investing activities	<u>1,895</u>	<u>779</u>	<u>2,674</u>	<u>13</u>
Net increase (decrease) in cash and cash equivalents	(29,641)	(124,631)	(154,272)	(14,169)
Cash and cash equivalents at beginning of year	<u>341,066</u>	<u>240,757</u>	<u>581,823</u>	<u>14,169</u>
Cash and cash equivalents at end of year	<u>\$ 311,425</u>	<u>\$ 116,126</u>	<u>\$ 427,551</u>	<u>\$ -</u>

CITY OF PALACIOS, TEXAS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
For the year ended September 30, 2010

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES				
Operating income (loss)	\$ 81,233	\$ (29,088)	\$ 52,145	\$ (230,428)
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation and amortization	464,150	16,001	480,151	60,438
Changes in assets and liabilities				
(Increase) decrease in accounts receivable	22,666	(23)	22,643	-
(Increase) decrease in inventory	(4,611)	(11,081)	(15,692)	-
Increase (decrease) in accounts payable	(18,772)	2,110	(16,662)	(918)
Increase (decrease) in accrued expenses	4,825	-	4,825	-
Increase (decrease) in compensated absences	1,631	-	1,631	-
Total adjustments	469,889	7,007	476,896	59,520
Net cash provided (used) by operating activities	\$ 551,122	\$ (22,081)	\$ 529,041	\$ (170,908)

SUPPLEMENTAL DISCLOSURES

Schedule of Noncash Investing and Financing Transactions

Infrastructure improvements contributed by real
estate developer \$ 10,650,403

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
September 30, 2010

	<u>Agency Fund</u>
ASSETS	
Cash and cash equivalents	\$ <u>210,312</u>
Total assets	<u>\$ 210,312</u>
LIABILITIES	
Liabilities	
Due to others	\$ <u>210,312</u>
Total liabilities	<u>\$ 210,312</u>

The accompanying notes are an integral part of this statement.

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NOTE 1: 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, 2010.

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 assets and the statement of changes in net assets) report information on all nonfiduciary 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 for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

The Debt Service Fund accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

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 internal service funds 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.

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

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 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, 2010, 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 assets. 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.

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

I. Capital Assets - (Continued)

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.

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 80 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 assets. 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.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)**K. Long-Term Obligations - (Continued)**

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.

L. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance, if any, represent tentative management plans that are subject to change.

M. 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 eight departments that expenditures exceeded the amount appropriated during the fiscal year 2009-2010.

<u>General Fund - Department</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Negative Variance</u>
Administration	\$ 459,940	\$ 485,135	\$ (25,195)
Legal	12,000	12,589	(589)
Police	888,690	991,798	(103,108)
Park maintenance	131,800	145,859	(14,059)
Streets	278,480	306,469	(27,989)
Animal control	7,250	10,391	(3,141)
Recycling center	37,330	41,502	(4,172)

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

Deficit Fund Equity

The Police Seized Drug Fund and the Public Assistance Grant Fund had a deficit fund balances of \$612 and \$190 at year-end, respectively. These deficits will be eliminated in the next fiscal year by fund transfers.

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.

As of September 30, 2010, 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	\$ 363,191	34

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 assets 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.

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 percent 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.

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, 2010, consist of the following:

	<u>General</u>	<u>Water and Sewer</u>	<u>Airport Fund</u>	<u>Nonmajor Funds</u>	<u>Total</u>
Gross receivables:					
Accounts	\$ 53,682	\$ 379,049	\$ 450	\$ -	\$ 433,181
Ad valorem taxes	595,709	-	-	-	595,709
Franchise taxes	13,554	-	-	-	13,554
Fines	67,050	-	-	-	67,050
Other	-	411	-	3,811	4,222
Total gross receivables	729,995	379,460	450	3,811	1,113,716
Less: allowances	<u>263,818</u>	<u>139,558</u>	<u>-</u>	<u>-</u>	<u>403,376</u>
Total net receivables	<u>\$ 466,177</u>	<u>\$ 239,902</u>	<u>\$ 450</u>	<u>\$ 3,811</u>	<u>\$ 710,340</u>

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	\$ 374,904	\$ -	\$ 374,904
Fines	67,050	-	67,050
Weedy lot mowing	<u>10,753</u>	<u>-</u>	<u>10,753</u>
	<u>\$ 452,707</u>	<u>\$ -</u>	<u>\$ 452,707</u>

The City's property taxes are levied annually on October 1st on the basis of the Appraisal District's assessed values as of January 1st 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 Palacios Independent School District and are due and payable on January 31st. 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 1st of the subsequent calendar year.

For the current year, the City levied property taxes of \$0.81316 per \$100 of assessed valuation, for maintenance and operations. The resulting adjusted total tax levy was \$1,138,359 on the total adjusted taxable valuation of \$161,882,720 for the 2009 tax roll.

NOTE 5: CAPITAL ASSETS

The City's capital assets activity for the year ended September 30, 2010, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Governmental activities				
Capital assets, not being depreciated				
Land	\$ 357,286	\$ -	\$ -	\$ 357,286
Total capital assets not being depreciated	<u>357,286</u>	<u>-</u>	<u>-</u>	<u>357,286</u>
Capital assets, being depreciated				
Machinery and equipment	1,846,746	23,864	22,168	1,848,442
Land structured facilities	4,196,959	9,009	-	4,205,968
Buildings	863,826	-	-	863,826
Total capital assets being depreciated	<u>6,907,531</u>	<u>32,873</u>	<u>22,168</u>	<u>6,918,236</u>
Less accumulated depreciation for				
Machinery and equipment	1,362,749	91,506	22,168	1,432,087
Land structured facilities	3,817,087	42,125	-	3,859,212
Buildings	236,612	16,004	-	252,616
Total accumulated depreciation	<u>5,416,448</u>	<u>149,635</u>	<u>22,168</u>	<u>5,543,915</u>
Total capital assets being depreciated, net	<u>1,491,083</u>	<u>(116,762)</u>	<u>-</u>	<u>1,374,321</u>
Governmental activities capital assets, net	<u>\$ 1,848,369</u>	<u>\$ (116,762)</u>	<u>\$ -</u>	<u>\$ 1,731,607</u>
Business-type activities				
Capital assets, not being depreciated				
Land	\$ 7,373	\$ -	\$ -	\$ 7,373
Construction in progress	-	94,354	-	94,354
Total capital assets not being depreciated	<u>7,373</u>	<u>94,354</u>	<u>-</u>	<u>101,727</u>
Capital assets, being depreciated				
Machinery and equipment	611,171	-	-	611,171
Buildings and improvements	3,471,118	-	-	3,471,118
Water and sewer system	6,262,136	10,650,403	-	16,912,539
Land structured facilities	1,190,407	-	-	1,190,407
Total capital assets being depreciated	<u>11,534,832</u>	<u>10,650,403</u>	<u>-</u>	<u>22,185,235</u>
Less accumulated depreciation for				
Machinery and equipment	603,990	3,728	-	607,718
Buildings and improvements	2,714,698	90,444	-	2,805,142
Water works system	2,552,469	357,162	-	2,909,631
Land structured facilities	800,598	24,305	-	824,903
Total accumulated depreciation	<u>6,671,755</u>	<u>475,639</u>	<u>-</u>	<u>7,147,394</u>
Total capital assets being depreciated, net	<u>4,863,077</u>	<u>10,174,764</u>	<u>-</u>	<u>15,037,841</u>
Business-type activities capital assets, net	<u>\$ 4,870,450</u>	<u>\$10,269,118</u>	<u>\$ -</u>	<u>\$15,139,568</u>

NOTE 5: CAPITAL ASSETS - (Continued)

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

Governmental activities

General government	\$ 36,736
Public safety	27,567
Public works	83,208
Public health	<u>2,124</u>

Total depreciation expense - governmental activities \$ 149,635

Business-type activities

Utilities	\$ 459,638
Airport	<u>16,001</u>

Total depreciation expense - business-type activities \$ 475,639

The Palacios Economic Development Corporation has \$12,799 of capital assets at September 30, 2010, consisting of various equipment and leasehold improvements. These assets were fully depreciated at September 30, 2010.

NOTE 6: EMPLOYEES' RETIREMENT PLAN

A. Plan Description

The City provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid defined benefit plan in the state-wide Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. At the date the plan began, the City granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began are a percent (100%, 150%, or 200%) of the employee's accumulated contributions. In addition, the City can grant, as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and the City matching percent had always been in existence and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity.

The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes. Members can retire at age 60 and above with five or more years of service or with twenty years of service regardless of age. A member is vested after five years.

NOTE 6: EMPLOYEES' RETIREMENT PLAN - (Continued)

B. Contributions

The contribution rate for the employees is 5%, and the City matching percent is currently 2 to 1, both as adopted by the governing body of the City. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his retirement becomes effective. The prior service contribution rate amortizes the unfunded actuarial liability over the remainder of the plan's 25-year amortization period. The unit credit actuarial cost method is used for determining the City contribution rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that is the basis for the rate and the calendar year when the rate goes into effect (i.e., December 31, 2007, valuation is effective for rates beginning January 2009).

C. Annual Pension Cost

For the employer's fiscal year ending September 30, 2010, the annual pension cost for the TMRS plan for its employees was \$90,083, and the actual contributions were \$90,083. The net pension obligation at the beginning and end of the fiscal year was zero.

D. Actuarial Valuation Information

Following is a tabular summary of actuarial valuation information for the December 31, 2009, December 31, 2008 and December 31, 2007, valuation dates:

	Actuarial Valuation Information		
	12/31/07	12/31/08	12/31/09
Actuarial cost method	projected unit credit	projected unit credit	Projected unit credit
Amortization method	level percent of payroll	level percent of payroll	level percent of payroll
Amortization period in years	30 - closed	29 - closed	28 - closed
Asset valuation method	amortized cost	amortized cost	10-year smoothed market
Investment return	7.00%	7.50%	7.50%
Projected salary increases	varies by age and service	varies by age and service	varies by age and service
Inflation	3.00%	3.00%	3.00%
Cost of living adjustments	2.1%	2.1%	2.1%

E. Trend Information

Information for the three most recent actuarial valuations for the TMRS plan follows:

Year Ended September 30	Contributions Required and Contributions Made		
	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2010	\$ 90,083	100%	\$ -
2009	80,812	100%	-
2008	79,941	100%	-

NOTE 6: EMPLOYEES' RETIREMENT PLAN - (Continued)E. Trend Information - (Continued)

Schedule of Funding Progress						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as of Percentage of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	((b-a)/c)
12/31/09	\$ 1,330,616	\$ 2,005,641	\$ 675,025	66.34%	\$1,236,169	54.60%
12/31/08	1,299,339	1,958,870	659,531	66.33%	1,220,172	54.10%
12/31/07	1,246,830	1,814,959	568,129	68.70%	1,075,651	52.80%
12/31/06	1,777,426	1,479,549	297,877	83.24%	981,787	30.77%
12/31/05	1,056,926	1,334,192	277,266	79.22%	928,603	29.85%
12/31/04	1,135,211	1,336,721	201,510	84.90%	881,498	22.90%
12/31/03	1,083,899	1,222,272	138,373	88.70%	909,694	15.20%
12/31/02	966,794	1,096,054	129,260	88.20%	863,664	14.97%
12/31/01	918,339	1,030,753	112,414	89.10%	668,544	16.81%
12/31/00	960,322	1,052,098	91,776	91.28%	689,503	13.31%

All assumptions for the December 31, 2009 valuations are contained in the 2009 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P.O. Box 149153, Austin, Texas 78714-9153.

NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEMPlan Description

The Fire Fighter's Pension Commissioner is the administrator of the Texas Emergency Services Retirement System (TESRS), a cost sharing multiple-employer pension system established and administered by the State of Texas (the "State") to provide pension benefits for emergency services personnel who serve without significant monetary remuneration. TESRS is considered a component unit of the State of Texas financial reporting entity and is included in the State's financial reports as a pension trust fund. At August 31, 2010, there were 198 members of fire or emergency services departments participating in TESRS. Eligible participants include volunteer emergency services personnel who are members in good standing of a participating department.

At August 31, 2010, TESRS membership consisted of:

Retirees and Beneficiaries Currently Receiving Benefits	2,152
Terminated Participants Entitled to Benefits but not yet receiving them	2,105
Active Participants (vested and nonvested)	<u>4,359</u>
	<u>8,616</u>

Senate Bill 411, 65th Legislature, Regular Session (1977), created TESRS, and established the applicable benefit provisions. The 79th Legislature, Regular Session (2005) recodified 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.

NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM - (Continued)

Plan Description - (Continued)

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.

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 and continuing monthly payments to a member's surviving spouse and dependent children.

Funding Policy

Contribution provisions were originally established by Senate Bill 411, 65th Legislature, Regular Session (1977) and were amended by board rule in 2006. No contributions are required by individual members of participating departments. The governing bodies of participating departments are required to contribute at least the minimum prescribed amount per month for each active member and may contribute more. Additional contributions may be made by a governing body to pay for granting credit for service before the department began participating in TESRS (prior service). The State may also be required to make annual contributions up to a limited amount to make TESRS actuarially sound.

Annual Required Contributions

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. For the fiscal year ending August 31, 2010, total contributions (dues and prior services) of \$2,875,103 were paid into TESRS by the political subdivisions served by the member volunteer emergency services personnel. The state did not appropriate any maximum State contribution for the fiscal years ending August 31, 2010 and 2011. Total contributions made were equal to the contributions required by the State statute and equal to the contributions required based on the August 31, 2008 actuarial valuation.

The purpose of the biennial actuarial valuation is to test the adequacy of the contribution arrangement to determine if it is adequate to pay the benefits that are promised. The actuarial valuation as of August 31, 2010, revealed the adequacy of the expected contributions from the political subdivisions (dues and prior service contributions) together with the actual State appropriations for the fiscal year ending August 31, 2010 (\$502,941 to help pay the System's administrative expenses) and with the assumed continuation of legislative appropriations of 1) the maximum State contribution amount in future years as is necessary for the TESRS to have a 30-year amortization period, 2) approximately \$500,000 each year to help pay for TESRS's administrative expenses. Expected contributions for the fiscal year ending August 31, 2011, are less than the contributions required because of the lag in time between an actuarial valuation that shows the need for maximum state contribution amounts and the appropriation process.

Without the expected future annual contributions from the State, the System would have an inadequate contribution arrangement.

NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM - (Continued)

Actuarial Valuation Information

Following is a tabular summary of actuarial valuation information for the August 31, 2010 and August 31, 2008, valuation dates:

	Actuarial Valuation Information	
	8/31/08	8/31/10
Actuarial cost method	entry age	entry age
Amortization method	level dollar, open	level dollar, open
Amortization period in years	6 years	30 years
Asset valuation method	market value smoothed by a 5-year deferred recognition method with a 90% - 110% corridor on market value	market value smoothed by a 5-year deferred recognition method with a 80% - 120% corridor on market value
Investment return	8.00%, net of expenses	7.75%, net of expenses
Projected salary increases	n/a	n/a
Inflation	3.50%	3.50%
Cost of living adjustment	none	none

Required Supplementary Information

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Liability ¹ (AAL) - Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Total Members Covered	UAAL per Member Covered
	(a)	(b)	(b)-(a)	(a/b)	(c)	(b-a)/(c)
8/31/2006	\$42,268,305	\$58,082,828	\$15,814,523	72.8%	8,061	\$ 1,962
8/31/2008	60,987,157	64,227,341	3,240,184	95.0%	8,254	393
8/31/2010 ³	64,113,803	79,953,215	15,839,412	80.2%	8,708	1,819

Notes:

¹ The actuarial accrued liability is based upon the entry age actuarial cost method.

² Changes in actuarial assumptions and methods, as well as benefit and contribution provisions, were first reflected in this valuation.

³ Changes in actuarial assumptions were reflected in this valuation.

Three-Year Trend Information

Fiscal Year Ending August 31	Annual Required Contributions	Actual Contributions	Percentage Contributed
2008	\$3,160,764 ¹	\$11,239,339	356%
2009	2,698,271 ²	2,698,271	100%
2010	2,875,103 ²	2,875,103	100%

Notes:

¹ Includes a state contribution of \$8,800,000.

² Based on the August 31, 2008, actuarial valuation.

NOTE 8: 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 1st of any year to be effective the following January 1st.

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 9: 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 10: LONG-TERM DEBT**A. Changes in Long-Term Liabilities**

Long-term liability activity for the year ended September 30, 2010, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Governmental activities					
Note payable	\$ 230,800	\$ -	\$ 34,100	\$ 196,700	\$ 35,800
Compensated absences	18,391	33,397	30,192	21,596	21,596
Total governmental activity long-term liabilities	<u>\$ 249,191</u>	<u>\$ 33,397</u>	<u>\$ 64,292</u>	<u>\$ 218,296</u>	<u>\$ 57,396</u>
Business-type activities					
General obligation bonds	\$ 690,000	\$ -	\$ 130,000	\$ 560,000	\$ 135,000
Compensated absences	7,021	11,176	9,545	8,652	8,652
Due to developer	-	1,250,965	-	1,250,965	75,000
Total business-type activity long-term liabilities	<u>\$ 697,021</u>	<u>\$ 1,262,141</u>	<u>\$ 139,545</u>	<u>\$ 1,819,617</u>	<u>\$ 218,652</u>

NOTE 10: LONG-TERM DEBT - (Continued)General Obligation Refunding Bonds

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 still \$575,000 of bonds outstanding of the original 1994 issue.

General obligation refunding bonds currently outstanding are as follows:

	<u>Term</u>	<u>Interest Rate</u>	<u>Original Amount</u>
Series 2004	2004 - 2014	1.50% - 3.80%	\$ 1,545,000

Annual debt service requirements to maturity for general obligation refunding bonds are as follows:

<u>Year</u>	<u>Business-type Activities</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2011	\$ 135,000	\$ 18,092	\$ 153,092
2012	140,000	13,280	153,280
2013	140,000	8,170	148,170
2014	145,000	2,755	147,755
	<u>\$ 560,000</u>	<u>\$ 42,297</u>	<u>\$ 602,297</u>

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 - 2018	3.25% - 4.25%	\$ 264,000

Annual debt service requirements to maturity for tax notes are as follows:

<u>Year</u>	<u>Governmental Activities</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2011	\$ 35,800	\$ 7,892	\$ 43,692
2012	37,500	6,549	44,049
2013	39,200	5,105	44,305
2014	41,100	3,537	44,637
2015	43,100	1,832	44,932
	<u>\$ 196,700</u>	<u>\$ 24,915</u>	<u>\$ 221,615</u>

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 in the 2009 fiscal year that totaled \$66,982 and \$87,154 in the 2010 fiscal year. The City has recorded the net liability of \$1,250,965 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 \$75,000.

NOTE 11: 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, 2010, were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Equipment Fund	\$ 71,661
	Water and Sewer	117,674
Nonmajor Governmental	General	4,025
Water and Sewer	Nonmajor Governmental	<u>10,658</u>
		<u>\$ 204,018</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>Total</u>
	<u>General Fund</u>	<u>Equipment Fund</u>	
General	\$ -	\$ 41,569	\$ 41,569
Nonmajor Governmental	60,080	-	60,080
Water and Sewer	363,033	120,647	483,680
Airport	<u>34,780</u>	<u>17,815</u>	<u>52,595</u>
	<u>\$ 457,893</u>	<u>\$ 180,031</u>	<u>\$ 637,924</u>

NOTE 12: COMMITMENTS AND CONTINGENCIES

Operating Leases

Commitments under operating lease agreements for equipment provide for minimum future rental payments as of September 30, 2010, as follows:

<u>Year Ended September 30</u>	
2011	\$ 11,799
2012	<u>1,967</u>
Total minimum rentals	<u>\$ 13,766</u>

Total rental expense incurred for the year was \$11,799.

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 collectibility of any related receivable at September 30, 2010, 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 13: ISSUED BUT NON-EFFECTIVE PRONOUNCEMENT

GASB Statement No. 54, "*Fund Balance Reporting and Governmental Fund Type Definitions*," (the "Statement") was issued in February 2009. The Statement eliminates the requirement to report governmental fund balances as reserved, unreserved, or designated. It replaces those categories with five possible classifications of governmental fund balances – nonspendable, restricted, committed, assigned, and unassigned. The Statement also redefines the governmental funds for clarity and to be consistent with these new fund balance classifications. The provisions of the Statement are effective for periods beginning after June 15, 2010.

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, 2010*

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Positive (Negative)</u>
REVENUES				
Taxes				
Ad valorem taxes	\$ 1,146,460	\$ 1,146,460	\$ 1,208,367	\$ 61,907
Other taxes	509,800	509,800	546,295	36,495
Licenses and permits	11,500	11,500	15,927	4,427
Intergovernmental	1,100	1,100	1,250	150
Charges for services	500	500	1,942	1,442
Fines and forfeitures	50,000	50,000	72,722	22,722
Investment income	1,000	1,000	2,070	1,070
Miscellaneous	<u>102,930</u>	<u>102,930</u>	<u>149,000</u>	<u>46,070</u>
Total revenues	<u>1,823,290</u>	<u>1,823,290</u>	<u>1,997,573</u>	<u>174,283</u>
EXPENDITURES				
Current				
General government	599,220	599,220	616,506	(17,286)
Public safety	906,010	906,010	1,008,667	(102,657)
Public works	410,280	410,280	452,328	(42,048)
Special services	204,200	204,200	180,850	23,350
Health and welfare	44,580	44,580	51,893	(7,313)
Debt service	-	-	43,185	(43,185)
Total expenditures	<u>2,164,290</u>	<u>2,164,290</u>	<u>2,353,429</u>	<u>(189,139)</u>
Excess (deficiency) of revenues over expenditures	(341,000)	(341,000)	(355,856)	(14,856)
OTHER FINANCING SOURCES (USES)				
Transfers in	424,090	424,090	457,893	33,803
Transfers out	<u>(35,000)</u>	<u>(35,000)</u>	<u>(41,569)</u>	<u>(6,569)</u>
Total other financing sources (uses)	<u>389,090</u>	<u>389,090</u>	<u>416,324</u>	<u>27,234</u>
Net change in fund balance	48,090	48,090	60,468	12,378
Fund balance at beginning of year	<u>321,406</u>	<u>321,406</u>	<u>321,406</u>	<u>-</u>
Fund balance at end of year	<u>\$ 369,496</u>	<u>\$ 369,496</u>	<u>\$ 381,874</u>	<u>\$ 12,378</u>

The accompanying notes are an integral part of this schedule.

CITY OF PALACIOS, TEXAS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

September 30, 2010

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, 2010 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>Actual</u>	<u>Negative Variance</u>
Administration	\$ 459,940	\$ 485,135	\$ (25,195)
Legal	12,000	12,589	(589)
Police	888,690	991,798	(103,108)
Park maintenance	131,800	145,859	(14,059)
Streets	278,480	306,469	(27,989)
Animal control	7,250	10,391	(3,141)
Recycling center	37,330	41,502	(4,172)

Combining and Individual Fund Statements and Schedules

CITY OF PALACIOS, TEXAS
NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
September 30, 2010

	Special Revenue Funds				
	Police Seized Drug	Hotel Motel Tax	Public Assistance Grant	Pavilion Restoration Fund	Recreation Center Renovation Fund
ASSETS					
Cash and cash equivalents	\$ 4,989	\$ 10,928	\$ 6,443	\$ 3,185	\$ -
Receivables (net)					
Taxes	-	3,811	-	-	-
Due from other funds	-	-	4,025	-	-
Total assets	<u>\$ 4,989</u>	<u>\$ 14,739</u>	<u>\$ 10,468</u>	<u>\$ 3,185</u>	<u>\$ -</u>
LIABILITIES AND FUND BALANCES					
Liabilities					
Due to other funds	\$ -	\$ -	\$ 10,658	\$ -	\$ -
Due to other governments	5,601	-	-	-	-
Total liabilities	<u>5,601</u>	<u>-</u>	<u>10,658</u>	<u>-</u>	<u>-</u>
Fund balances					
Unreserved, undesignated	(612)	14,739	(190)	3,185	-
Total fund balances	<u>(612)</u>	<u>14,739</u>	<u>(190)</u>	<u>3,185</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 4,989</u>	<u>\$ 14,739</u>	<u>\$ 10,468</u>	<u>\$ 3,185</u>	<u>\$ -</u>

Special Revenue Funds					Debt Service Fund	
Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency	Safe School Bridge	2004 Refunding Bonds	Total
\$ 11,255	\$ 7,992	\$ 5,019	\$ 919	\$ 23,147	\$ -	\$ 73,877
-	-	-	-	-	-	3,811
-	-	-	-	-	-	4,025
<u>\$ 11,255</u>	<u>\$ 7,992</u>	<u>\$ 5,019</u>	<u>\$ 919</u>	<u>\$ 23,147</u>	<u>\$ -</u>	<u>\$ 81,713</u>
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10,658
-	-	-	-	-	-	5,601
-	-	-	-	-	-	16,259
11,255	7,992	5,019	919	23,147	-	65,454
11,255	7,992	5,019	919	23,147	-	65,454
<u>\$ 11,255</u>	<u>\$ 7,992</u>	<u>\$ 5,019</u>	<u>\$ 919</u>	<u>\$ 23,147</u>	<u>\$ -</u>	<u>\$ 81,713</u>

CITY OF PALACIOS, TEXAS
NONMAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
For the year ended September 30, 2010

	Special Revenue Funds				
	Police Seized Drug	Hotel Motel Tax	Public Assistance Grant	Pavilion Restoration Fund	Recreation Center Renovation Fund
REVENUES					
Taxes					
Hotel - motel tax	\$ -	\$ 15,259	\$ -	\$ -	\$ -
Court fees	-	-	-	-	-
Intergovernmental	-	-	4,256	-	-
Investment income					
Interest	18	92	-	-	-
Miscellaneous	-	-	-	60	-
Total revenues	<u>18</u>	<u>15,351</u>	<u>4,256</u>	<u>60</u>	<u>-</u>
EXPENDITURES					
Current					
General government					
Promotional expense	-	14,000	-	-	-
Public safety	-	-	-	-	-
Public works	-	-	4,256	-	76
Total expenditures	<u>-</u>	<u>14,000</u>	<u>4,256</u>	<u>-</u>	<u>76</u>
Excess (deficiency) of revenues over expenditures	18	1,351	-	60	(76)
OTHER FINANCING SOURCES (USES)					
Transfers out	(630)	(5,000)	-	-	-
Total other financing sources (uses)	<u>(630)</u>	<u>(5,000)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	(612)	(3,649)	-	60	(76)
Fund balances at beginning of year	-	18,388	(190)	3,125	76
Fund balances at end of year	<u>\$ (612)</u>	<u>\$ 14,739</u>	<u>\$ (190)</u>	<u>\$ 3,185</u>	<u>\$ -</u>

Special Revenue Funds					Debt Service Fund	
Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency	Safe School Bridge	2004 Refunding Bonds	Total
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 15,259
2,280	1,710	-	166	-	-	4,156
-	-	-	-	-	-	4,256
39	52	-	-	77	-	278
-	-	-	-	32,080	-	32,140
<u>2,319</u>	<u>1,762</u>	<u>-</u>	<u>166</u>	<u>32,157</u>	<u>-</u>	<u>56,089</u>
-	-	-	-	-	-	14,000
-	-	210	-	-	-	210
-	-	-	-	9,010	-	13,342
-	-	<u>210</u>	-	<u>9,010</u>	-	<u>27,552</u>
2,319	1,762	(210)	166	23,147	-	28,537
-	-	630	-	-	(55,080)	(60,080)
-	-	<u>630</u>	-	-	<u>(55,080)</u>	<u>(60,080)</u>
2,319	1,762	420	166	23,147	(55,080)	(31,543)
8,936	6,230	4,599	753	-	55,080	96,997
<u>\$ 11,255</u>	<u>\$ 7,992</u>	<u>\$ 5,019</u>	<u>\$ 919</u>	<u>\$ 23,147</u>	<u>\$ -</u>	<u>\$ 65,454</u>

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 constitutional 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, 2010
With comparative totals for September 30, 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash and cash equivalents	\$ 190,301	\$ 187,812
Receivables (net)		
Accounts	24,224	44,687
Taxes	374,903	380,825
Fines	67,050	61,465
Due from other governments	83,861	73,585
Due from other funds	189,335	134,638
Inventory	14,059	11,613
Total assets	<u>\$ 943,733</u>	<u>\$ 894,625</u>
 LIABILITIES AND FUND BALANCES		
Liabilities		
Accounts payable	\$ 67,656	\$ 59,488
Accrued expenses	32,053	52,011
Due to other funds	4,025	4,025
Due to other governments	5,418	4,844
Deferred revenue	452,707	452,851
Total liabilities	<u>561,859</u>	<u>573,219</u>
 Fund balances		
Reserved for inventory	14,059	11,613
Unreserved		
Undesignated	367,815	309,793
Total fund balances	<u>381,874</u>	<u>321,406</u>
 Total liabilities and fund balances	<u>\$ 943,733</u>	<u>\$ 894,625</u>

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, 2010

With comparative totals for the year ended September 30, 2009

	2010		Variance Positive (Negative)	2009
	Final Budget	Actual		Actual
REVENUES				
Ad valorem taxes				
Current and delinquent taxes	\$ 1,107,720	\$ 1,149,908	\$ 42,188	\$ 1,064,627
Penalty and interest	31,740	46,949	15,209	37,121
Tax certificates, other fees	7,000	11,510	4,510	6,847
Total ad valorem taxes	<u>1,146,460</u>	<u>1,208,367</u>	<u>61,907</u>	<u>1,108,595</u>
Other taxes				
Sales tax	237,400	261,088	23,688	254,477
Property tax reduction sales tax	118,700	130,544	11,844	127,239
Franchise tax	143,000	146,694	3,694	145,482
Bingo tax	3,200	2,933	(267)	3,076
Mixed beverage tax	7,500	5,036	(2,464)	6,229
Total other taxes	<u>509,800</u>	<u>546,295</u>	<u>36,495</u>	<u>536,503</u>
Licenses and permits				
Building and moving permits	10,000	13,132	3,132	10,630
Dog licenses	1,500	2,795	1,295	2,360
Total licenses and permits	<u>11,500</u>	<u>15,927</u>	<u>4,427</u>	<u>12,990</u>
Intergovernmental				
Grant proceeds	<u>1,100</u>	<u>1,250</u>	<u>150</u>	<u>28,709</u>
Charges for services				
Weedy lot mowing	<u>500</u>	<u>1,942</u>	<u>1,442</u>	<u>9,857</u>
Fines and forfeitures				
Fines and court costs	<u>50,000</u>	<u>72,722</u>	<u>22,722</u>	<u>54,071</u>
Investment income				
Interest	<u>1,000</u>	<u>2,070</u>	<u>1,070</u>	<u>3,642</u>
Miscellaneous				
Insurance reimbursement	16,580	30,644	14,064	37,759
Maintenance contract	50,000	50,000	-	50,000
Other	36,350	68,356	32,006	48,356
Total miscellaneous	<u>102,930</u>	<u>149,000</u>	<u>46,070</u>	<u>136,115</u>
Total revenues	<u>1,823,290</u>	<u>1,997,573</u>	<u>174,283</u>	<u>1,890,482</u>

(continued)

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, 2010

With comparative totals for the year ended September 30, 2009

	2010			2009
	Final Budget	Actual	Variance Positive (Negative)	Actual
EXPENDITURES				
General government				
Mayor and city council				
Salaries and wages	\$ 10,200	\$ 10,100	\$ 100	\$ 10,400
Office supplies	1,500	1,419	81	1,128
Special services	100	537	(437)	60
Travel, training, and dues	4,200	2,302	1,898	3,531
Social security tax	790	868	(78)	842
Employee benefits	40	30	10	7
Total mayor and city council	<u>16,830</u>	<u>15,256</u>	<u>1,574</u>	<u>15,968</u>
Elections				
Office supplies	1,100	1,161	(61)	1,106
Special services	1,350	767	583	562
Total elections	<u>2,450</u>	<u>1,928</u>	<u>522</u>	<u>1,668</u>
Administrative				
Salaries and wages	271,760	267,250	4,510	268,085
Office supplies	11,000	9,344	1,656	12,812
Maintenance - office equipment	12,920	17,404	(4,484)	13,580
Maintenance - buildings	1,100	1,150	(50)	906
Telephone	7,090	7,197	(107)	6,970
Electricity	11,500	8,856	2,644	11,609
Gas	300	256	44	202
Professional fees	10,950	12,884	(1,934)	11,623
Special services	20,790	49,971	(29,181)	53,634
Travel, training, and dues	9,050	7,259	1,791	18,631
Social security tax	20,790	20,472	318	20,436
Employee benefits	72,540	71,407	1,133	69,623
Capital outlay	10,150	11,685	(1,535)	8,215
Total administrative	<u>459,940</u>	<u>485,135</u>	<u>(25,195)</u>	<u>496,326</u>
Legal				
Special services	<u>12,000</u>	<u>12,589</u>	<u>(589)</u>	<u>12,124</u>

(continued)

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, 2010

With comparative totals for the year ended September 30, 2009

	2010			2009
	Final Budget	Actual	Variance Positive (Negative)	Actual
EXPENDITURES - (CONTINUED)				
General government - (continued)				
Corporation court				
Salaries and wages	\$ 55,960	\$ 52,425	\$ 3,535	\$ 51,197
Office supplies	300	239	61	356
Maintenance - office equipment	3,680	3,400	280	3,206
Telephone	500	579	(79)	510
Special services	970	174	796	708
Travel, training, and dues	1,500	255	1,245	1,487
Social security tax	4,290	4,036	254	3,923
Employee benefits	8,990	8,876	114	8,883
Capital outlay	1,810	2,614	(804)	-
Total corporation court	<u>78,000</u>	<u>72,598</u>	<u>5,402</u>	<u>70,270</u>
Library				
Special services	<u>30,000</u>	<u>29,000</u>	<u>1,000</u>	<u>33,544</u>
Total general government	<u>599,220</u>	<u>616,506</u>	<u>(17,286)</u>	<u>629,900</u>
Public safety				
Police department				
Salaries and wages	594,440	686,830	(92,390)	624,813
Minor tools	1,700	2,378	(678)	1,259
Office supplies	6,500	6,682	(182)	7,767
Clothing	2,500	4,628	(2,128)	2,566
Maintenance - buildings	800	1,014	(214)	881
Maintenance - radios/radar	500	281	219	280
Maintenance - office equipment	13,900	15,257	(1,357)	21,758
Telephone, electricity, and gas	17,060	18,401	(1,341)	15,199
Special services	11,820	12,726	(906)	17,505
Travel, training, and dues	8,000	5,316	2,684	7,123
Support of prisoners	500	530	(30)	419
Social security tax	45,480	52,986	(7,506)	47,794
Employee benefits	173,070	167,557	5,513	146,690
Capital outlay	12,420	17,212	(4,792)	18,677
Total police department	<u>888,690</u>	<u>991,798</u>	<u>(103,108)</u>	<u>912,731</u>

(continued)

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, 2010

With comparative totals for the year ended September 30, 2009

	2010			2009
	Final Budget	Actual	Variance Positive (Negative)	Actual
EXPENDITURES - (CONTINUED)				
Public safety - (continued)				
Fire department				
Minor tools	\$ 1,000	\$ -	\$ 1,000	\$ -
Chemicals	500	-	500	-
Maintenance - equipment	200	-	200	-
Maintenance - buildings	100	-	100	-
Maintenance - radios	300	-	300	-
Telephone	1,100	1,104	(4)	1,166
Electricity	2,200	1,871	329	2,038
Gas	200	191	9	157
Travel, training, and dues	1,000	-	1,000	-
Special services	9,220	11,444	(2,224)	11,695
Employee benefits	500	426	74	476
Capital outlay	1,000	1,833	(833)	196
Total fire department	<u>17,320</u>	<u>16,869</u>	<u>451</u>	<u>15,728</u>
Total public safety	<u>906,010</u>	<u>1,008,667</u>	<u>(102,657)</u>	<u>928,459</u>
Public works				
Park maintenance				
Minor tools	6,000	7,773	(1,773)	8,459
Chemicals	1,000	-	1,000	-
Reconstruction materials	5,000	-	5,000	-
Electricity	30,000	27,527	2,473	30,378
Special services	89,800	110,559	(20,759)	95,981
Capital outlay	-	-	-	2,000
Total park maintenance	<u>131,800</u>	<u>145,859</u>	<u>(14,059)</u>	<u>136,818</u>

(continued)

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, 2010

With comparative totals for the year ended September 30, 2009

	2010		Variance Positive (Negative)	2009
	Final Budget	Actual		Actual
EXPENDITURES - (CONTINUED)				
Public works - (continued)				
Streets				
Salaries and wages	\$ 58,410	\$ 22,767	\$ 35,643	\$ 38,500
Minor tools	7,000	6,362	638	7,411
Chemicals	2,600	4,313	(1,713)	2,261
Clothing	400	123	277	182
Maintenance - radios	100	-	100	-
Reconstruction materials	10,000	53,346	(43,346)	14,958
Pipe and culverts	4,000	11,327	(7,327)	4,040
Electricity	38,000	80,012	(42,012)	41,096
Special services	12,550	21,403	(8,853)	25,237
Social security tax	4,470	1,742	2,728	2,945
Employee benefits	25,450	13,371	12,079	18,051
Capital outlay	115,500	91,703	23,797	162,072
Total streets	<u>278,480</u>	<u>306,469</u>	<u>(27,989)</u>	<u>316,753</u>
Total public works	<u>410,280</u>	<u>452,328</u>	<u>(42,048)</u>	<u>453,571</u>
Health and welfare				
Animal control				
Minor tools	1,000	3,535	(2,535)	664
Supplies	800	872	(72)	770
Telephone	700	612	88	709
Electricity	2,500	2,793	(293)	2,957
Special services	550	2,233	(1,683)	2,310
Travel, training, and dues	200	346	(146)	-
Capital outlay	1,500	-	1,500	-
Total animal control	<u>7,250</u>	<u>10,391</u>	<u>(3,141)</u>	<u>7,410</u>
Recycling center				
Salaries and wages	20,990	22,937	(1,947)	21,684
Minor tools	1,320	1,856	(536)	1,745
Telephone	750	847	(97)	-
Electricity	1,600	1,692	(92)	2,233
Special services	500	2,818	(2,318)	1,194
Travel, training, and dues	600	127	473	941
Social security tax	1,610	1,723	(113)	1,615
Employee benefits	9,960	9,502	458	9,454
Total recycling center	<u>37,330</u>	<u>41,502</u>	<u>(4,172)</u>	<u>38,866</u>
Total health and welfare	<u>44,580</u>	<u>51,893</u>	<u>(7,313)</u>	<u>46,276</u>

(continued)

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, 2010

With comparative totals for the year ended September 30, 2009

	2010		Variance Positive (Negative)	2009
	Final Budget	Actual		Actual
EXPENDITURES - (CONTINUED)				
Special services				
Unemployment	\$ 2,000	\$ 8,704	\$ (6,704)	\$ 7,928
Note principal	34,100	34,100	-	33,200
Note interest	9,090	9,085	5	9,797
Hospital assistance	10,000	10,000	-	10,000
Development agreement rebate	83,180	87,154	(3,974)	66,982
Insurance and bonds	55,830	70,738	(14,908)	54,346
Community improvements	10,000	4,254	5,746	16,905
Total special services	<u>204,200</u>	<u>224,035</u>	<u>(19,835)</u>	<u>199,158</u>
Total expenditures	<u>2,164,290</u>	<u>2,353,429</u>	<u>(189,139)</u>	<u>2,257,364</u>
Excess (deficiency) of revenues over expenditures	(341,000)	(355,856)	(14,856)	(366,882)
OTHER FINANCING SOURCES (USES)				
Transfers in	424,090	457,893	33,803	456,640
Transfers out	<u>(35,000)</u>	<u>(41,569)</u>	<u>(6,569)</u>	<u>(58,081)</u>
Total other financing sources (uses)	<u>389,090</u>	<u>416,324</u>	<u>27,234</u>	<u>398,559</u>
Net change in fund balance	48,090	60,468	12,378	31,677
Fund balance at beginning of year	<u>321,406</u>	<u>321,406</u>	<u>-</u>	<u>289,729</u>
Fund balance at end of year	<u>\$ 369,496</u>	<u>\$ 381,874</u>	<u>\$ 12,378</u>	<u>\$ 321,406</u>

(concluded)

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 the 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 ASSETS
September 30, 2010
With comparative totals for September 30, 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 311,425	\$ 341,066
Receivables		
Accounts	379,050	370,897
Other	410	31,229
Allowance for uncollectible accounts	(139,558)	(139,558)
Due from other funds	10,658	10,658
Inventory	48,098	43,487
Total current assets	<u>610,083</u>	<u>657,779</u>
Noncurrent assets		
Capital assets		
Office equipment and furniture	47,715	47,715
Machinery and equipment	482,563	482,563
Service delivery system	16,912,539	6,262,136
Buildings and fixtures	3,404,639	3,404,639
Land structured facilities	760,184	760,184
Total capital assets	21,607,640	10,957,237
Accumulated depreciation	(6,848,480)	(6,388,842)
Subtotal	<u>14,759,160</u>	<u>4,568,395</u>
Land	7,373	7,373
Net capital assets	<u>14,766,533</u>	<u>4,575,768</u>
Deferred expenses (net)	40,992	51,241
Total noncurrent capital assets	<u>14,807,525</u>	<u>4,627,009</u>
Total assets	<u>15,417,608</u>	<u>5,284,788</u>
LIABILITIES		
Current liabilities		
Accounts payable	76,619	95,391
Accrued expenses	17,443	12,618
Due to other funds	117,674	79,668
Accrued interest payable	1,508	2,885
Customer meter deposits	108,080	106,003
Accrued compensated absences	8,652	7,021
Current portion of payable to developer	75,000	-
Current portion of general obligation bonds	135,000	130,000
Total current liabilities	<u>539,976</u>	<u>433,586</u>
Noncurrent liabilities		
General obligation bonds	425,000	560,000
Due to developer	1,175,965	-
Total noncurrent liabilities	<u>1,600,965</u>	<u>560,000</u>
Total liabilities	<u>2,140,941</u>	<u>993,586</u>
NET ASSETS		
Invested in capital assets, net of related debt	14,247,525	3,937,009
Unrestricted net assets (deficit)	(970,858)	354,193
Total net assets	<u>\$ 13,276,667</u>	<u>\$ 4,291,202</u>

CITY OF PALACIOS, TEXAS

MAJOR ENTERPRISE FUND - WATER AND SEWER FUND

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

For the year ended September 30, 2010

With comparative totals for the year ended September 30, 2009

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Charges for services	\$ 1,874,969	\$ 1,891,380
OPERATING EXPENSES		
Water system	539,276	493,948
Sanitary sewer system	228,379	207,640
Solid waste	545,720	523,695
Miscellaneous	16,211	16,794
Depreciation	459,638	263,048
Amortization	4,512	4,512
Total operating expenses	<u>1,793,736</u>	<u>1,509,637</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	<u>81,233</u>	<u>381,743</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income		
Interest	1,895	6,033
Connection fees	4,800	17,990
Miscellaneous income (expense)	8,705	9,679
Interest and fiscal charges	<u>(26,926)</u>	<u>(26,794)</u>
Total nonoperating revenues (expenses)	<u>(11,526)</u>	<u>6,908</u>
Income (loss) before contributions and transfers	69,707	388,651
Contributions and transfers		
Capital contributions	9,399,438	157,252
Transfers out	<u>(483,680)</u>	<u>(653,988)</u>
Total contributions and transfers	<u>8,915,758</u>	<u>(496,736)</u>
Change in net assets	8,985,465	(108,085)
Total net assets at beginning of year	<u>4,291,202</u>	<u>4,399,287</u>
Total net assets at end of year	<u>\$ 13,276,667</u>	<u>\$ 4,291,202</u>

CITY OF PALACIOS, TEXAS
MAJOR ENTERPRISE FUND - AIRPORT FUND
STATEMENT OF NET ASSETS
September 30, 2010
With comparative totals for September 30, 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 116,126	\$ 240,757
Accounts receivable	450	427
Inventory	24,649	13,568
Total current assets	<u>141,225</u>	<u>254,752</u>
Noncurrent assets		
Capital assets		
Machinery and equipment	80,893	80,893
Buildings and fixtures	66,479	66,479
Land structured facilities	430,223	430,223
Total capital assets	<u>577,595</u>	<u>577,595</u>
Accumulated depreciation	(298,914)	(282,913)
Subtotal	<u>278,681</u>	<u>294,682</u>
Construction in progress	94,354	-
Net capital assets	<u>373,035</u>	<u>294,682</u>
Total assets	<u>514,260</u>	<u>549,434</u>
LIABILITIES		
Accounts payable	12,383	732
Total liabilities	<u>12,383</u>	<u>732</u>
NET ASSETS		
Invested in capital assets	373,035	294,682
Unrestricted net assets	128,842	254,020
Total net assets	<u>\$ 501,877</u>	<u>\$ 548,702</u>

CITY OF PALACIOS, TEXAS**MAJOR ENTERPRISE FUND - AIRPORT FUND****STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS**

For the year ended September 30, 2010

With comparative totals for the year ended September 30, 2009

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Charges for services	\$ 42,006	\$ 15,661
Rental income	<u>32,345</u>	<u>33,674</u>
Total operating revenues	<u>74,351</u>	<u>49,335</u>
OPERATING EXPENSES		
Airport expenses		
Supplies	36,098	19,308
Repairs and maintenance	1,259	-
Utilities	12,806	12,557
Insurance and bonds	13,098	14,399
Special items	24,177	29,217
Depreciation	<u>16,001</u>	<u>16,312</u>
Total operating expenses	<u>103,439</u>	<u>91,793</u>
Operating income (loss) before nonoperating revenues (expenses) and transfers	<u>(29,088)</u>	<u>(42,458)</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income		
Interest	779	1,903
Miscellaneous income (expense)	11,904	7,042
Nonoperating lease income	<u>22,175</u>	<u>36,800</u>
Total nonoperating revenues (expenses)	<u>34,858</u>	<u>45,745</u>
Income (loss) before transfers	5,770	3,287
Transfers		
Transfer out	<u>(52,595)</u>	<u>(53,850)</u>
Total transfers	<u>(52,595)</u>	<u>(53,850)</u>
Change in net assets	(46,825)	(50,563)
Total net assets at beginning of year	<u>548,702</u>	<u>599,265</u>
Total net assets at end of year	<u>\$ 501,877</u>	<u>\$ 548,702</u>

OVERALL COMPLIANCE AND INTERNAL CONTROL SECTION



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**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**

The Honorable Mayor and Members
of City Council
City of Palacios, Texas

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, and the aggregated remaining fund information of the City of Palacios, Texas (the "City"), as of and for the year ended September 30, 2010, which collectively comprise the City's basic financial statements and have issued our report thereon dated January 19, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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 misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of 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 that are required to be reported under *Government Auditing Standards*.

The Honorable Mayor and Members
of City Council

This communication is intended solely for the information and use of management, the Mayor and City Council, others within the organization, and other federal and state awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Harrison Waldrop + Uherick, LLP.

January 19, 2011

CITY OF PALACIOS, TEXAS

SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS

For the year ended September 30, 2010

None were noted.

CITY OF PALACIOS, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the year ended September 30, 2010

None were noted.