

**CITY OF PALACIOS, TEXAS**  
*ANNUAL FINANCIAL REPORT*  
For the Year Ended September 30, 2014

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## **INTRODUCTORY SECTION**

# City of Palacios, Texas

DIRECTORY OF PRINCIPAL OFFICIALS

September 30, 2014

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## City Officials

John Sardelich

Johnny Tran

Judy Chavez

Ed Schulze

Gary Hafernick

Andy Erdelt

Troy Lewis

## Elective Position

Mayor

Council Member

Council Member

Council Member

Council Member

Council Member

Council Member

## Key Staff

David Kocurek

Randall B. Strong

Linh Chau

Robert Seward

David Miles

Jackie Jones

## Appointive Position

City Manager

City Attorney

Municipal Court Judge

City Secretary

Chief of Police

City Treasurer

## **FINANCIAL SECTION**

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

316 E. Jackson  
El Campo, TX 77437

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

INDEPENDENT AUDITOR'S REPORT

To the City Council  
City of Palacios, Texas

**Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

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

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

***Auditor's Responsibility***

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

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

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

***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of September 30, 2014, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the



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

#### *Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Palacios, Texas' basic financial statements. The introductory section, combining and individual non-major fund financial statements, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

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

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated February 18, 2015, on our consideration of the City of Palacios, Texas' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering City of Palacios, Texas' internal control over financial reporting and compliance.

*Baker Stogner & Associates*

El Campo, Texas

February 18, 2015

**CITY OF PALACIOS, TEXAS**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**September 30, 2014**

**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, 2014.**

**FINANCIAL HIGHLIGHTS**

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$18,727,115 (*net position*). Of this amount, \$1,549,094 (*unrestricted net position*) may be used to meet the City's ongoing obligations to citizens and creditors.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$857,935, an increase of \$80,550 from the prior year. At the end of the current fiscal year, unassigned fund balance for the General Fund was \$697,086, or 31% of total General Fund expenditures.
- The City's total debt of business-type activities decreased by \$498,801 or 8% during the fiscal year, ending with a balance of \$4,992,937 of which \$329,580 is due within one year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

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

**Organization and Flow of Financial Section Information**

**Independent Auditors' Report**

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

**Management's Discussion and Analysis**

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

Pages 9 to 15

**Government-wide Financial Statements**

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

Pages 17 to 20

**Fund Financial Statements**

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

Pages 21 to 29

**Notes to Financial Statements**

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

Pages 31 to 52

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

### Government-wide Financial Statements

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

### Statement of Net Position

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

### Statement of Activities

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

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

### Fund Financial Statements

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

### Governmental Funds

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

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

The City maintained fifteen individual governmental funds during the 2013-2014 fiscal year. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General Fund which is considered a major fund. Data from the other twelve governmental funds are combined into a single, aggregated presentation.

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

### Governmental Funds - (Continued)

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

### Proprietary Funds

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

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

### Fiduciary Funds

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

### Notes to Financial Statements

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

### Other Information

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

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

## **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$18,727,115 at the close of the fiscal year 2014.

By far, the largest portion of the City's net position (91%) reflects its investment in capital assets (i.e., land, buildings, machinery and equipment), less a related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

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

<b>City of Palacios, Texas</b>						
<b>Net Position</b>						
	Governmental Activities		Business-type Activities		Total	
	2,014	2,013	2,014	2,013	2,014	2,013
Current and other assets	\$ 1,412,231	\$ 1,468,385	\$ 606,853	\$ 810,847	\$ 2,019,084	\$ 2,279,232
Capital assets (net)	2,011,505	2,013,105	20,126,119	19,347,708	22,137,624	21,360,813
Other noncurrent assets	-	3,425	45,730	62,052	45,730	65,477
<b>Total assets</b>	<u>3,423,736</u>	<u>3,484,915</u>	<u>20,778,702</u>	<u>20,220,607</u>	<u>24,202,438</u>	<u>23,705,522</u>
Deferred Outflow of Resource	-	-	-	-	-	-
Current liabilities	223,062	338,380	547,669	739,419	770,731	1,077,799
Noncurrent liabilities	41,236	110,768	4,663,356	5,038,480	4,704,592	5,149,248
<b>Total liabilities</b>	<u>264,298</u>	<u>449,148</u>	<u>5,211,025</u>	<u>5,777,899</u>	<u>5,475,323</u>	<u>6,227,047</u>
Deferred Inflow of Resources	-	-	-	-	-	-
<b>Net Position</b>						
Invested in capital assets, net of related debt	2,039,800	1,836,051	15,174,221	13,979,244	17,214,021	15,815,295
Unrestricted	<u>1,119,638</u>	<u>1,199,716</u>	<u>393,456</u>	<u>463,464</u>	<u>1,513,094</u>	<u>1,663,180</u>
<b>Total net position</b>	<u>\$ 3,159,438</u>	<u>\$ 3,035,767</u>	<u>\$ 15,567,677</u>	<u>\$ 14,442,708</u>	<u>\$ 18,727,115</u>	<u>\$ 17,478,475</u>

The balance of unrestricted net position, \$1,513,094, may be used to meet the government's ongoing obligations to its citizens and creditors.

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

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

Governmental activities increased the City's net position by \$127,095. Business-type activities decreased the City's net position by \$1,124,969.

<b>City of Palacios, Texas</b>						
<b>Changes in Net Position</b>						
	Governmental		Business-type		Total	
	Activities		Activities		Total	
	2,014	2,013	2,014	2,013	2,014	2,013
<b>REVENUES</b>						
Program revenues:						
Charges for services	\$ 113,607	\$ 115,346	\$ 1,814,637	\$ 2,504,013	\$ 1,928,244	\$ 2,619,359
Operating grants and contributions	24,121	62,803	-	-	24,121	62,803
Capital grants and contributions	1,561,468	795,585	-	24,087	1,561,468	819,672
General revenues:						
Property taxes	1,332,295	1,337,289	-	-	1,332,295	1,337,289
Sales taxes	513,058	664,490	-	-	513,058	664,490
Franchise taxes	143,170	141,619	-	-	143,170	141,619
Other taxes	43,917	29,108	-	-	43,917	29,108
Unrestricted investment earnings	1,831	1,191	1,115	2,788	2,946	3,979
Miscellaneous	226,148	218,335	172,306	64,662	398,454	282,997
<b>Total revenues</b>	<u>3,959,615</u>	<u>3,365,766</u>	<u>1,988,058</u>	<u>2,595,550</u>	<u>5,947,673</u>	<u>5,961,316</u>
<b>EXPENSES</b>						
General government	676,701	763,420	-	-	676,701	763,420
Public safety	1,287,724	1,250,108	-	-	1,287,724	1,250,108
Public works	1,925,618	1,339,369	-	-	1,925,618	1,339,369
Special services	98,182	107,688	-	-	98,182	107,688
Health and welfare	66,793	93,350	-	-	66,793	93,350
Interest on long-term debt	3,938	5,905	-	-	3,938	5,905
Water and sewer	-	-	1,801,226	2,225,800	1,801,226	2,225,800
Airport	-	-	113,759	121,206	113,759	121,206
<b>Total expenses</b>	<u>4,058,956</u>	<u>3,559,840</u>	<u>1,914,985</u>	<u>2,347,006</u>	<u>5,973,941</u>	<u>5,906,846</u>
Change in net position before capital contributions and transfers	(99,341)	(194,074)	73,073	248,544	(26,268)	54,470
Capital contributions			1,278,332			
Transfers	226,436	238,625	(226,436)	(238,625)	-	-
Change in net position	127,095	44,551	1,124,969	9,919	(26,268)	54,470
Net position - beginning	<u>3,032,343</u>	<u>2,987,792</u>	<u>14,442,708</u>	<u>14,432,789</u>	<u>17,475,051</u>	<u>17,420,581</u>
Net position - ending	<u>\$3,159,438</u>	<u>\$3,032,343</u>	<u>\$ 15,567,677</u>	<u>\$ 14,442,708</u>	<u>\$ 17,448,783</u>	<u>\$ 17,475,051</u>

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

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

**Governmental Funds**

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

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$857,933, an increase of \$80,550 from the prior year.

Approximately 81% of this total amount, \$697,086 constitutes unassigned fund balance, which is available for spending at the City's discretion. The remainder of fund balance of \$160,849 or 19% is non-spendable or restricted.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, unassigned fund balance was \$697,086. Unreserved fund balance represents 2831% of total General Fund expenditures.

The fund balance of the City's General Fund increased by \$13,388 during the current fiscal year. The increase was primarily due to the increase in tax revenue.

**Proprietary Funds**

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

Unrestricted net position of the Water and Sewer Fund at the end of the current fiscal year amounted to \$377,553. Unrestricted net position of the Airport Fund amounted to \$13,903 at the end of the current fiscal year, which is a decrease of \$73,571 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 \$22,137,625 (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 16% (a 16% increase in business-type activities).

**Capital Assets (Net of Depreciation)**

	Governmental Activities		Business-type Activities		Total	
	2,014	2,013	2,014	2,013	2,014	2,013
Land	\$ 357,286	\$ 357,286	\$ 8,129	\$ 8,129	\$ 365,415	\$ 365,415
Construction in progress	113,271	-	1,278,332	3,627,998	1,391,603	3,627,998
Buildings and improvements	563,855	581,206	316,429	406,872	880,284	988,078
Machinery and equipment	325,662	366,858	449,680	566,491	775,342	933,349
Land structured facilities	651,431	707,755	1,323,850	1,242,834	1,975,281	1,950,589
Water and sewer system	-	-	16,749,700	13,495,386	16,749,700	13,495,386
<b>Total</b>	<b>\$ 2,011,505</b>	<b>\$ 2,013,105</b>	<b>\$ 20,126,120</b>	<b>\$ 19,347,710</b>	<b>\$ 22,137,625</b>	<b>\$ 21,360,815</b>

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

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

### **Long-Term Debt**

During the 2011 fiscal year, the City issued \$3,580,000 in Certificate of Obligation Bonds in order to fund water and sewer improvements. The City retired the remaining \$145,000 of the prior outstanding debt issue, the 2004 General Obligation Refunding Bonds. The amount that is outstanding at year-end totals \$3,400,000. The City also retired \$41,160 of the tax notes issued in 2008 for the purchase of the new City Hall. The amount outstanding on the tax notes total \$43,100. The 2011 bonds mature in 2031, 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 \$1,082,187. The City retired \$88,234 debt in the form of an eight year capital lease. Additional information on the City's long-term debt can be found in Note 10.

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

The following factors were considered in preparing the City's budget for the 2013-2014 fiscal year.

The total sales tax payments received by the City from the State Comptroller in fiscal year 2014 totaled \$513,058. This amount is an decrease of \$151,432 or 36% over the previous year.

The certified assessed taxable property valuations for the 2014 tax roll total \$166,796,004 with a tax rate of \$0.85787 per \$100 valuation. The tax rate remained the same as last year. \$0.82612 was allocated for maintenance and operations, and \$0.03175 was allocated for interest and sinking (debt service). The projected total property tax due is \$1,346,860 for the 2014 tax year. The certified assessed taxable property valuations were more than the 2013 values.

Of the \$1,346,860 of projected 2014 property tax due, and using a 95% collection rate, \$77,162 is projected to be collected from the newly annexed Beachside subdivision. Of the \$77,162 projected collection, \$50,000 would be payable to the developer of the Beachside subdivision as per the City's development agreement.

The development agreement provides that in exchange for the developer's financing and extending of the off site water and sewer lines to the development, the City agreed to reimburse 75% of collected tax revenue and tap fees generated from the development site until the total reimbursement amount equals the extension costs. The amount of \$1,405,101 was agreed upon by the developer and the City for the extension of the water and sewer lines. As of the end of the fiscal year, \$352,914 had been reimbursed leaving a balance of \$1,052,187.

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

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

### **Requests for Information**

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



## **BASIC FINANCIAL STATEMENTS**

**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF NET POSITION**  
September 30, 2014

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 806,842	\$ 270,848	\$ 1,077,690	\$ 387,768
Receivables (net)	460,944	289,382	750,326	2,850
Internal balances	52,423	(52,423)	-	-
Due from other governments	82,351	-	82,351	26,639
Inventory	9,671	99,046	108,717	-
Total current assets	<u>1,412,231</u>	<u>606,853</u>	<u>2,019,084</u>	<u>417,257</u>
Noncurrent assets				
Capital assets				
Land and other assets not being depreciated	470,557	1,286,461	1,757,018	-
Buildings, improvements, and equipment (net)	1,540,948	18,839,658	20,380,606	-
Deferred expenses (net)	-	45,730	45,730	-
Total noncurrent assets	<u>2,011,505</u>	<u>20,171,849</u>	<u>22,183,354</u>	<u>-</u>
<b>Total assets</b>	<u>3,423,736</u>	<u>20,778,702</u>	<u>24,202,438</u>	<u>417,257</u>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
None	-	-	-	-
Total Deferred Outflow of Resources	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable	\$ 72,181	\$ 78,706	\$ 150,887	\$ 18,837
Accrued expenses	25,921	8,001	33,922	827
Accrued interest payable	-	16,038	16,038	-
Due to other governments	26,110	-	26,110	-
Customer meter deposits	-	115,344	115,344	-
Accrued compensated absences	29,319	11,346	40,665	107
Payable to developer	-	50,000	50,000	-
Current portion of long-term obligations	69,531	268,234	337,765	-
Total current liabilities	<u>223,062</u>	<u>547,669</u>	<u>770,731</u>	<u>19,771</u>
Noncurrent liabilities				
Noncurrent portion of long-term obligations	41,236	4,663,356	4,704,592	-
Total noncurrent liabilities	<u>41,236</u>	<u>4,663,356</u>	<u>4,704,592</u>	<u>-</u>
<b>Total liabilities</b>	<u>264,298</u>	<u>5,211,025</u>	<u>5,475,323</u>	<u>19,771</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
None	-	-	-	-
Total Deferred Inflows of Resources	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>NET POSITION</b>				
Net investment in capital assets	2,039,800	15,174,221	17,214,021	-
Unrestricted	<u>1,119,638</u>	<u>393,456</u>	<u>1,513,094</u>	<u>397,486</u>
<b>Total net position</b>	<u>\$ 3,159,438</u>	<u>\$ 15,567,677</u>	<u>\$ 18,727,115</u>	<u>\$ 397,486</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

STATEMENT OF ACTIVITIES

For the year ended September 30, 2014

Function/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary Government</b>				
Governmental activities				
General government	\$ 676,701	\$ 32,885	\$ -	\$ -
Public safety	1,287,724	80,722	-	-
Public works	1,925,618	-	24,121	1,561,468
Special services	98,182	-	-	-
Health and welfare	66,793	-	-	-
Interest on long-term debt	3,938	-	-	-
Total governmental activities	<u>4,058,956</u>	<u>113,607</u>	<u>24,121</u>	<u>1,561,468</u>
Business-type activities				
Water and sewer	1,801,226	1,781,690	-	-
Airport	113,759	32,947	-	-
Total business-type activities	<u>1,914,985</u>	<u>1,814,637</u>	<u>-</u>	<u>-</u>
Total primary government	<u>\$ 5,973,941</u>	<u>\$ 1,928,244</u>	<u>\$ 24,121</u>	<u>\$ 1,561,468</u>
<b>Component Unit</b>				
Palacios Economic Development Corporation	<u>\$ 155,028</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

General revenues:

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

Net (Expense) Revenue and Changes in Net Position			Component Unit
Primary Government			
Governmental Activities	Business- type Activities	Total	Palacios Economic Development Corporation
(643,816)	\$ -	\$ (643,816)	\$ -
(1,207,002)	-	(1,207,002)	-
(340,029)	-	(340,029)	-
(98,182)	-	(98,182)	-
(66,793)	-	(66,793)	-
(3,938)	-	(3,938)	-
<u>(2,359,760)</u>	<u>-</u>	<u>(2,359,760)</u>	<u>-</u>
-	(19,536)	(19,536)	-
<u>-</u>	<u>(80,812)</u>	<u>(80,812)</u>	<u>-</u>
-	(100,348)	(100,348)	-
<u>(2,359,760)</u>	<u>(100,348)</u>	<u>(2,460,108)</u>	<u>-</u>
-	-	-	(155,028)
1,277,779	-	1,277,779	-
54,516	-	54,516	-
513,058	-	513,058	171,019
143,170	-	143,170	-
43,917	-	43,917	-
1,831	1,115	2,946	1,256
226,148	172,306	398,454	10,570
226,436	(226,436)	-	-
<u>-</u>	<u>1,278,332</u>	<u>1,278,332</u>	<u>-</u>
<u>2,486,855</u>	<u>1,225,317</u>	<u>3,712,172</u>	<u>182,845</u>
127,095	1,124,969	1,252,064	27,817
<u>3,032,343</u>	<u>14,442,708</u>	<u>17,475,051</u>	<u>369,669</u>
<u>\$ 3,159,438</u>	<u>\$ 15,567,677</u>	<u>\$ 18,727,115</u>	<u>\$ 397,486</u>

**CITY OF PALACIOS, TEXAS***BALANCE SHEET**GOVERNMENTAL FUNDS**September 30, 2014*

---

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	\$ 633,775	\$ 168,991	\$ 802,766
Receivables (net)	450,208	10,736	460,944
Due from other governments	82,351	-	82,351
Due from other funds	58,302	-	58,302
Inventory	9,671	-	9,671
<b>Total assets</b>	<u>1,234,307</u>	<u>179,727</u>	<u>1,414,034</u>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>Liabilities</b>			
Accounts payable	51,596	6,821	58,417
Accrued expenditures	25,921	-	25,921
Due to other funds	-	5,879	5,879
Due to other governments	14,469	11,641	26,110
<b>Total liabilities</b>	<u>91,986</u>	<u>24,341</u>	<u>116,327</u>
<b>Deferred Inflows of Resources</b>			
Unearned Revenue	435,564	4,208	439,772
<b>Total Deferred Inflow of Resources</b>	<u>435,564</u>	<u>4,208</u>	<u>439,772</u>
<b>Fund balances</b>			
Nonspendable	9,671	-	9,671
Restricted	-	151,178	151,178
Unassigned	697,086	-	697,086
<b>Total fund balances</b>	<u>706,757</u>	<u>151,178</u>	<u>857,935</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,234,307</u>	<u>\$ 179,727</u>	<u>\$ 1,414,034</u>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

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

*September 30, 2014*

---

**Total governmental fund balances** \$ 857,935

*Amounts reported for governmental activities in the statement of net position are different because:*

The Internal Service Fund is used by the City to account for the costs of equipment owned by the City. The assets and liabilities of the Internal Service Fund are included in governmental activities in the statement of net position. 94,257

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. 439,772

Capital assets used in governmental activities are reported as expenditures in governmental funds when purchased or constructed. The cost of these assets is \$6,375,167 and the accumulated depreciation is \$4,730,592. 1,839,893

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	\$ (43,100)	
Compensated absences	<u>(29,319)</u>	<u>(72,419)</u>

**Net position of governmental activities** **\$ 3,159,438**

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, 2014

	General	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>			
Taxes	\$ 2,000,665	\$ 93,856	\$ 2,094,521
Licenses and permits	32,885	-	32,885
Intergovernmental	24,121	1,561,468	1,585,589
Charges for services	-	-	-
Fines and forfeitures	76,538	4,184	80,722
Investment income	1,526	302	1,828
Miscellaneous	129,419	40,000	169,419
<b>Total revenues</b>	<u>2,265,154</u>	<u>1,699,810</u>	<u>3,964,964</u>
<b>EXPENDITURES</b>			
Current			
General government	557,597	39,879	597,476
Public safety	1,146,356	-	1,146,356
Public works	391,552	1,573,954	1,965,506
Special services	98,182	-	98,182
Health and welfare	51,792	-	51,792
Debt service			
Principal retirement	-	41,100	41,100
Interest and fiscal charges	-	3,938	3,938
<b>Total expenditures</b>	<u>2,245,479</u>	<u>1,658,871</u>	<u>3,904,350</u>
Excess (deficiency) of revenues over expenditures	19,675	40,939	60,614
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in	155,602	31,225	186,827
Transfers out	(161,889)	(5,002)	(166,891)
<b>Total other financing sources (uses)</b>	<u>(6,287)</u>	<u>26,223</u>	<u>19,936</u>
Net change in fund balances	13,388	67,162	80,550
Fund balances (as restated), at beginning of year	<u>693,369</u>	<u>84,016</u>	<u>777,385</u>
<b>Fund balances at end of year</b>	<u>\$ 706,757</u>	<u>\$ 151,178</u>	<u>\$ 857,935</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, 2014*

---

**Total net change in fund balances - governmental funds** \$ 80,550

*Amounts reported for governmental activities in the statement of activities are different because:*

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. (20,006)

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 2012-2013 capital outlays is to increase net position. 152,552

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 position. (115,426)

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 41,100

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. (5,352)

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 compensated absences \$ (6,323) (6,323)

**Change in net position of governmental activities** **\$ 127,095**

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**  
**STATEMENT OF NET POSITION**  
**PROPRIETARY FUNDS**  
September 30, 2014

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>ASSETS</b>				
Current assets				
Cash and cash equivalents	\$ 270,848	\$ -	\$ 270,848	\$ 4,076
Receivables (net)	288,657	725	289,382	-
Due from other funds	277	-	277	-
Inventory	76,857	22,189	99,046	-
<b>Total current assets</b>	<b>636,639</b>	<b>22,914</b>	<b>659,553</b>	<b>4,076</b>
Noncurrent assets				
Land and other assets not being depreciated	1,286,461	-	1,286,461	-
Buildings, improvements, and equipment (net)	17,537,951	1,301,707	18,839,658	171,612
Prepaid Insurance	45,730	-	45,730	-
<b>Total noncurrent assets</b>	<b>18,870,142</b>	<b>1,301,707</b>	<b>20,171,849</b>	<b>171,612</b>
<b>Total assets</b>	<b>19,506,781</b>	<b>1,324,621</b>	<b>20,831,402</b>	<b>175,688</b>
<b>LIABILITIES</b>				
Current liabilities				
Accounts payable	77,672	1,034	78,706	13,764
Accrued expenses	8,001	-	8,001	-
Due to other funds	46,723	5,977	52,700	-
Accrued interest payable	16,038	-	16,038	-
Customer meter deposits	115,344	-	115,344	-
Accrued compensated absences	11,346	-	11,346	-
Current portion of notes	88,234	-	88,234	26,431
Current portion of payable to developer	50,000	-	50,000	-
Current portion of general obligation bonds	180,000	-	180,000	-
<b>Total current liabilities</b>	<b>593,358</b>	<b>7,011</b>	<b>600,369</b>	<b>40,195</b>
Noncurrent liabilities				
Notes payable	441,169	-	441,169	41,237
General obligation bonds	-	-	-	-
Certificates of obligation	3,220,000	-	3,220,000	-
Payable to developer	1,002,187	-	1,002,187	-
<b>Total noncurrent liabilities</b>	<b>4,663,356</b>	<b>-</b>	<b>4,663,356</b>	<b>41,237</b>
<b>Total liabilities</b>	<b>5,256,714</b>	<b>7,011</b>	<b>5,263,725</b>	<b>81,432</b>
<b>NET POSITION</b>				
Net investment in capital assets	13,872,514	1,301,707	15,174,221	103,944
Unrestricted net position	377,553	15,903	393,456	(9,687)
<b>Total net position</b>	<b>\$ 14,250,067</b>	<b>\$ 1,317,610</b>	<b>\$ 15,567,677</b>	<b>\$ 94,257</b>

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

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

PROPRIETARY FUNDS

For the year ended September 30, 2014

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>OPERATING REVENUES</b>				
Charges for services	\$ 1,781,690	\$ 20,920	\$ 1,802,610	\$ -
Rents	-	12,027	12,027	-
<b>Total operating revenues</b>	<u>1,781,690</u>	<u>32,947</u>	<u>1,814,637</u>	<u>-</u>
<b>OPERATING EXPENSES</b>				
Water system	645,617	-	645,617	-
Sanitary sewer system	282,086	-	282,086	-
Solid waste	-	-	-	-
Airport expenses	-	67,610	67,610	-
Miscellaneous	19,654	-	19,654	-
Equipment expenses	-	-	-	166,782
Depreciation and amortization	704,031	46,149	750,180	59,727
<b>Total operating expenses</b>	<u>1,651,388</u>	<u>113,759</u>	<u>1,765,147</u>	<u>226,509</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	130,302	(80,812)	49,490	(226,509)
<b>NONOPERATING REVENUES (EXPENSES)</b>				
Investment income	1,114	-	1,114	3
Connection fees	6,300	-	6,300	-
Miscellaneous income	2,420	129,749	132,169	-
Nonoperating lease income	-	33,837	33,837	-
Interest and fiscal charges	(149,838)	-	(149,838)	-
<b>Total nonoperating revenues (expenses)</b>	<u>(140,004)</u>	<u>163,587</u>	<u>23,582</u>	<u>3</u>
Income (loss) before contributions and transfers	(9,702)	82,775	73,072	(226,506)
Contributions and transfers				
Capital contributions	1,278,332	-	1,278,332	-
Transfers in	91,889	-	91,889	206,500
Transfers out	(316,825)	(1,500)	(318,325)	-
Total contributions and transfers	<u>1,053,396</u>	<u>(1,500)</u>	<u>1,051,896</u>	<u>206,500</u>
Change in net position	1,043,694	81,275	1,124,968	(20,006)
Total net position at beginning of year	<u>13,206,373</u>	<u>1,236,335</u>	<u>14,442,708</u>	<u>114,263</u>
<b>Total net position at end of year</b>	<u>\$ 14,250,067</u>	<u>\$ 1,317,610</u>	<u>\$ 15,567,676</u>	<u>\$ 94,257</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, 2014

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Cash received from customers	\$ 1,775,290	\$ 45,554	\$ 1,820,844	\$ -
Cash paid to suppliers for goods and services	(660,704)	(62,028)	(722,732)	(165,025)
Cash paid to employees for services	(318,076)	-	(318,076)	-
<b>Net cash provided (used) by operating activities</b>	<u>796,510</u>	<u>(16,474)</u>	<u>780,036</u>	<u>(165,025)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>				
Transfers (to) from other funds	(224,936)	(1,500)	(226,436)	206,500
Borrowings (repayments) to other funds	(277)	(9,991)	(10,268)	-
Connection fees	6,300	-	6,300	-
Miscellaneous income (expense)	2,420	163,586	166,006	-
Increase (decrease) in customer meter deposits	<u>1,515</u>	<u>-</u>	<u>1,515</u>	<u>-</u>
<b>Net cash provided (used) by noncapital financing activities</b>	<u>(214,978)</u>	<u>152,095</u>	<u>(62,883)</u>	<u>206,500</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>				
Acquisition and construction of capital assets	(114,636)	(135,622)	(250,258)	(21,000)
Change in prepaid interest	16,322	-	16,322	-
Proceeds from issuance of debt	-	-	-	-
Principal paid on long-term debt	(505,124)	-	(505,124)	(25,188)
Interest paid	<u>(150,977)</u>	<u>-</u>	<u>(150,977)</u>	<u>-</u>
<b>Net cash provided (used) by capital and related financing activities</b>	<u>(754,415)</u>	<u>(135,622)</u>	<u>(890,037)</u>	<u>(46,188)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Investment income	<u>1,114</u>	<u>1</u>	<u>1,115</u>	<u>3</u>
<b>Net cash provided (used) by investing activities</b>	<u>1,114</u>	<u>1</u>	<u>1,115</u>	<u>3</u>
Net increase (decrease) in cash and cash equivalents	(171,769)	-	(171,769)	(4,710)
Cash and cash equivalents at beginning of year	<u>442,617</u>	<u>-</u>	<u>442,617</u>	<u>8,786</u>
<b>Cash and cash equivalents at end of year</b>	<u>\$ 270,848</u>	<u>\$ -</u>	<u>\$ 270,848</u>	<u>\$ 4,076</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, 2014

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>				
Operating income (loss)	\$ 130,302	\$ (80,812)	\$ 49,490	\$ (226,509)
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation and amortization	704,031	46,149	750,180	59,727
Changes in assets and liabilities				
(Increase) decrease in accounts receivable	(6,400)	12,607	6,207	-
(Increase) decrease in inventory	16,673	19,613	36,286	-
Increase (decrease) in accounts payable	(54,505)	(14,031)	(68,536)	1,757
Increase (decrease) in accrued expenses	87	-	87	-
Increase (decrease) in compensated absences	6,322	-	6,322	-
Total adjustments	<u>666,208</u>	<u>64,338</u>	<u>730,546</u>	<u>61,484</u>
<b>Net cash provided (used) by operating activities</b>	<u>\$ 796,510</u>	<u>\$ (16,474)</u>	<u>\$ 780,036</u>	<u>\$ (165,025)</u>
<b>Noncash capital and related financing activities</b>				
Infrastructure improvements contributed by other funds				
	<u>\$ 1,278,332</u>			

The accompanying notes are an integral part of this statement.

**CITY OF PALACIOS, TEXAS**

*STATEMENT OF FIDUCIARY NET POSITION*

*FIDUCIARY FUNDS*

*September 30, 2014*

---

	<u>Agency Fund</u>
<b>ASSETS</b>	
Cash and cash equivalents	\$ <u>53,764</u>
<b>Total assets</b>	\$ <u><u>53,764</u></u>
<b>LIABILITIES</b>	
Liabilities	
Due to others	\$ <u>53,764</u>
<b>Total liabilities</b>	\$ <u><u>53,764</u></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.

The City adopted two new GASB statements. GASB 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, which was effective for financial statements periods beginning after December 15, 2011, established report standards for the deferred outflows and inflows of resources and changed presentation titles of the financial statements.

The City chose to adopt GASB 65, Items Previously Reported as Assets and Liabilities, which is effective for financial statement periods beginning after December 15, 2012. That statement established accounting and financial reporting standards that reclassify certain items that were previously reported as assets and liabilities as deferred outflows and deferred inflows.

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



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

**B. Component Unit - (Continued)**

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, 2014.

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.

**C. Government-wide and Fund Financial Statements**

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

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

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

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

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are

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

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

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.

The City reports the following major governmental fund:

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

The City reports the following major proprietary funds:

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

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

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

Additionally, the City reports the following fund types:

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

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

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

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

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

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

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.

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

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

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

E. Budgets and Budgetary Accounting

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

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

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

E. Budgets and Budgetary Accounting - (Continued)

6. All appropriations lapse at year-end. The City does not employ the use of encumbrances in its budgetary accounting.

F. Deposits and Investments

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

The City may invest its excess funds in any instruments authorized by the Public Funds Investment Act of Texas. Investments authorized under this Act include, but are not limited to, the following: Obligations of the United States or its agencies and instrumentalities; direct obligations of the State of Texas or its agencies and instrumentalities; collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the 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, 2014, the City has adopted a formal investment policy.

G. Receivables and Payables

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

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

H. Inventory and Prepaid Items

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

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

I. Capital Assets

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

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

I. Capital Assets - (continued)

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

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

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

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 position. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. Losses or gains on refunding are capitalized and amortized over the shorter life of the new issuance or the life on existing debt.

**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

GASB Statement No. 54, “Fund Balance Reporting and Governmental Fund Type Definitions,” (the “Statement”) was issued in February 2009. This 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. This Statement also redefines the governmental funds for clarity and to be consistent with these new fund balance classifications. The provisions of this Statement are effective for periods beginning after June 15, 2010. The City did not adopt a new fund balance policy in accordance with GASB Statement No. 54 during fiscal year 2011. This Statement did not have an impact on the City’s functions, financial position or results of operations.

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 two departments that expenditures exceeded the amount appropriated during the fiscal year 2013-2014.

<u>General Fund - Department</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Negative Variance</u>
Fire Department	\$ 34,700	\$ 34,859	\$ (159)
Police	1,051,500	1,111,497	(59,997)

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

**NOTE 3: DEPOSITS AND INVESTMENTS**

The City’s funds are required to be deposited and invested under the terms of a depository contract pursuant to the Texas Public Funds Investment Act. The depository bank pledges securities which comply with state law and these securities are held for safekeeping and trust with the City’s and the depository bank’s agent bank. The pledge of approved securities is waived only to the extent of the depository bank’s dollar amount of FDIC insurance. Pledged securities at Compass Bank for the year ended 9/30/14 were \$2,145,000 in collateral value and \$2,224,688 in market value.

As of September 30, 2014, 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	\$ 460,635	44

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

Interest Rate Risk

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

Credit Risk

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

Concentration of Credit Risk

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

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City’s deposits may not be returned to it. The City’s investment policy requires that deposits at financial institutions be insured by the FDIC and/or collateralized by securities pledged to the City by the depository in an amount equal to at least 110% of the carrying value of deposits held. During the fiscal year and at year-end, all deposits held in the depository bank were fully collateralized and therefore the City was not exposed to custodial credit risk. Pledged securities at Compass Bank for the year ended 9/30/14 were \$2,145,000 in collateral value and \$2,224,688 in market value.

Custodial Credit Risk - Investments

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

**NOTE 4: RECEIVABLES**

Receivables at September 30, 2014, 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	\$ 39,608	\$ 452,249	\$ 4,060	\$ -	\$ 495,917
Ad valorem taxes	587,638	-	-	4,676	592,314
Franchise taxes	17,106	-	-	-	17,106
Fines	72,492	-	-	-	72,492
Other	<u>-</u>	<u>1,532</u>	<u>-</u>	<u>6,528</u>	<u>8,060</u>
Total gross receivables	716,844	453,781	4,060	11,204	1,185,889
Less: allowances	<u>266,636</u>	<u>165,124</u>	<u>3,335</u>	<u>468</u>	<u>435,563</u>
Total net receivables	<u>\$ 450,208</u>	<u>\$ 288,657</u>	<u>\$ 725</u>	<u>\$ 10,736</u>	<u>\$ 750,326</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	\$ 361,955	\$ -	\$ 361,955
Fines	72,492	-	72,492
Weedy lot mowing	1,117	-	1,117
Debt Service Fund			
Ad valorem taxes	<u>4,208</u>	<u>-</u>	<u>4,208</u>
	<u>\$ 439,772</u>	<u>\$ -</u>	<u>\$ 439,772</u>

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

For the current year, the City levied property taxes of \$0.85787 per \$100 of assessed valuation. \$0.82357 was allocated for maintenance and operations, and \$0.0343 was allocated for interest and sinking (debt service). The resulting adjusted total tax levy was \$1,337,439 on the total adjusted taxable valuation of \$163,816,312 for the 2013 tax roll.



**NOTE 5: CAPITAL ASSETS**

The City's capital assets activity for the year ended September 30, 2013, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
<b>Governmental activities</b>				
Capital assets, not being depreciated				
Land	\$ 357,286	\$ -	\$ -	\$ 357,286
Construction in progress	-	113,271	-	113,271
Total capital assets not being depreciated	<u>357,286</u>	<u>113,271</u>	<u>-</u>	<u>470,557</u>
Capital assets, being depreciated				
Machinery and equipment	2,115,700	60,281	-	2,175,981
Land structured facilities	4,718,044	-	-	4,718,044
Buildings	884,829	-	-	884,829
Total capital assets being depreciated	<u>7,718,573</u>	<u>60,281</u>	<u>-</u>	<u>7,778,854</u>
Less accumulated depreciation for				
Machinery and equipment	1,748,842	101,477	-	1,850,319
Land structured facilities	4,010,289	56,324	-	4,066,613
Buildings	303,622	17,352	-	320,974
Total accumulated depreciation	<u>6,062,753</u>	<u>175,153</u>	<u>-</u>	<u>6,237,906</u>
Total capital assets being depreciated, net	<u>1,655,820</u>	<u>(114,872)</u>	<u>-</u>	<u>1,540,948</u>
Governmental activities capital assets, net	<u>\$ 2,013,106</u>	<u>\$ (1,601)</u>	<u>\$ -</u>	<u>\$ 2,011,505</u>
<b>Business-type activities</b>				
Capital assets, not being depreciated				
Land	\$ 8,129	\$ -	\$ -	\$ 8,129
Construction in progress	3,627,998	1,278,332	3,627,998	1,278,332
Total capital assets not being depreciated	<u>3,636,127</u>	<u>1,278,332</u>	<u>3,627,998</u>	<u>1,286,461</u>
Capital assets, being depreciated				
Machinery and equipment	1,073,579	-	-	1,073,579
Buildings and improvements	3,471,118	-	-	3,471,118
Water and sewer system	17,832,007	3,742,635	-	21,574,642
Land structured facilities	2,205,899	135,622	-	2,341,521
Total capital assets being depreciated	<u>24,582,603</u>	<u>3,878,257</u>	<u>-</u>	<u>28,460,860</u>
Less accumulated depreciation for				
Machinery and equipment	564,620	59,279	-	623,899
Buildings and improvements	3,064,246	90,443	-	3,154,689
Water works system	4,279,089	545,852	-	4,824,941
Land structured facilities	963,065	54,606	-	1,017,671
Total accumulated depreciation	<u>8,871,021</u>	<u>750,180</u>	<u>-</u>	<u>9,621,201</u>
Total capital assets being depreciated, net	<u>15,711,583</u>	<u>3,128,077</u>	<u>-</u>	<u>18,839,659</u>
Business-type activities capital assets, net	<u>\$19,347,710</u>	<u>\$ 4,406,409</u>	<u>\$3,627,998</u>	<u>\$20,126,120</u>

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

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

**Governmental activities**

General government	\$ 67,310
Public safety	47,056
Public works	50,896
Public health	<u>9,891</u>

Total depreciation expense - governmental activities \$ 175,153

**Business-type activities**

Utilities	\$ 704,031
Airport	<u>46,149</u>

Total depreciation expense - business-type activities \$ 750,180

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

**Governmental activities**

General government	\$ 73,916
Public safety	51,674
Public works	55,891
Public health	<u>10,862</u>

Total depreciation expense - governmental activities \$ 192,343

**Business-type activities**

Utilities	\$ 562,681
Airport	<u>41,536</u>

Total depreciation expense - business-type activities \$ 604,217

The Palacios Economic Development Corporation has \$12,799 of capital assets at September 30, 2013, consisting of various equipment and leasehold improvements. These assets were fully depreciated at September 30, 2013.

**NOTE 6: EMPLOYEES' RETIREMENT PLAN**

Plan Description

The City provides pension benefits for all of its eligible employees through a nontraditional, joint contributory, hybrid defined benefit plan in the statewide Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system. The plan provisions that have been adopted by the City are within the options available in the governing state statutes of TMRS.

TMRS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information (RSI) for TMRS; the report also provides detailed explanations of the contributions, benefits and actuarial methods and assumptions used by TMRS. This report may be obtained from TMRS' website at [www.TMRS.com](http://www.TMRS.com). The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS. Plan provisions for the City were as follows:

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

	Plan Year 2013	Plan Year 2014
Employee deposit rate	7.0%	7.0%
Matching ratio (city to employee)	2 to 1	2 to 1
Years required for vesting	5	5
Service retirement eligibility (expressed as age/years of service)	60/5, 0/20	60/5, 0/20
Updated service credit	100% repeating transfers	100% repeating transfers
Annuity increase (to retirees)	70% of CPI repeating	70% of CPI repeating

Contributions

Under the state law governing TMRS, the contribution rate for each city is determined annually by the actuary, using the Entry Age Normal (EAN) cost method (EAN was first used in the December 2013 valuation; previously the Projected Unit Credit actuarial cost method had been used). This rate consists of the normal cost contribution rate and the prior service cost contribution rate, which is calculated to be a level percent of payroll from year to year. The normal cost contribution rate for an employee is the contribution rate which, if applied to a member's compensation throughout their period of anticipated covered service with the municipality, would be sufficient to meet all benefits payable on their behalf. The salary-weighted average of the individual rates is the total normal cost rate. The prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the applicable period for that city. Both the normal cost and prior service contribution rates include recognition of the projected impact of annually repeating benefits, such as Updated Service Credits and Annuity Increases.

The City contributes to the TMRS Plan at an actuarially determined 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 serves as the basis for the rate and the calendar year when the rate goes into effect (i.e., the December 31, 2013 valuation will determine the contribution rate beginning January 1, 2015). The annual pension cost and net pension obligation (asset) are as follows:

Contributions Required and Contributions Made			
Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
9/30/2014			
2011	\$ 114,492	100%	\$ -
2012	192,569	100%	-
2013	217,797	100%	-
2014	235,165	100%	-

The required contribution rates for fiscal year 2014 were determined as part of the December 31, 2011 and 2012 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2013, also follows:

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

**Actuarial Valuation Information**

	12/31/2011	12/31/2012	12/31/2013
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Entry Age Normal
Amortization method	Level Percent of Payroll	Level Percent of Payroll	Level Percent of Payroll
GASB 25 equivalent single amortization period	28.9 years; closed period	27.3 years; closed period	25.0 years; closed period
Amortization period for new gains/losses	30 years	30 years	30 years
Asset valuation method	10-year Smoothed Market	10-year Smoothed Market	10-year Smoothed Market
Investment rate of return *	7.00%	7.00%	7.50%
Projected salary increases *	Varies by age and service	Varies by age and service	Varies by age and service
*Includes Inflation at Cost of living adjustments	3.00%	3.00%	3.00%
Cost of living adjustments	2.10%	2.10%	2.10%
Cost of living adjustments	2.10%	2.10%	2.10%

Funded Status and Funding Progress

In October 2013, the TMRS Board approved actuarial changes in (a) the funding method from Projected Unit Credit to Entry Age Normal, (b) the post-retirement mortality assumptions used in calculating liabilities and contribution rates and in the development of the Annuity Purchase Rate factors, and (c) the amortization policy. These actuarial changes were effective with the December 31 2013 actuarial valuation. For a complete description of the new actuarial cost method and assumptions, please see the December 31, 2013 TMRS Comprehensive Annual Financial Report (CAFR).

The funded status as of December 31, 2013, the most recent actuarial valuation date, is presented as follows:

Schedule of Funding Status

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2012	\$ 2,842,932	\$ 4,212,867	\$ 1,369,935	67.5%	\$ 1,490,464	91.9%

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

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability of benefits.

Required Supplementary Information

Texas Municipal System

(Unaudited)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2009	\$ 1,330,616	\$ 2,005,641	\$ 675,025	66.3%	\$ 1,236,169	54.6%
12/31/2010	2,263,123	3,465,504	1,202,381	65.3%	1,278,418	94.1%
12/31/2011	2,498,805	3,815,360	1,316,555	65.5%	1,347,581	97.7%
12/31/2013	3,203,803	4,940,499	1,726,696	65.1%	1,397,926	123.5%

**NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM**

A. Plan Description

The Texas Emergency Services Retirement System (TESRS) administers a cost-sharing multiple employer pension system (the System) established and administered by the State of Texas to provide pension benefits for emergency services personnel who serve without significant monetary remuneration. Direct financial activity for the System is classified in the financial statements as pension trust funds. Of the nine member state board of trustees, at least five trustees must be active members of the pension system, one of whom must represent emergency medical services personnel. One trustee may be a retiree of the pension system, and three trustees must be persons who have experience in the fields of finance, securities investment, or pension administration. At August 31, 2014, there were 198 contributing fire and/or emergency services department members participating in TESRS. Eligible participants include volunteer emergency services personnel who are members in good standing of a member department.

At August 31, 2014, TESRS membership consisted of:

Retirees & Beneficiaries Currently Receiving Benefits	3,073
Terminated Members Entitled to Benefits, but not yet receiving them	2,161
Active Participants (Vested and Nonvested)	4,036

**NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM – (Continued)**

A. Plan Description – (Continued)

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

and gave the TESRS Board of Trustees authority to establish vesting requirements, contribution levels, benefit formulas, and eligibility requirements by board rule. The benefit provisions include retirement benefits as well as death and disability benefits. Members are 50% vested after the tenth year of service, with the vesting percent increasing 10% for each of the next five years of service so that a member becomes 100% vested with 15 years of service.

Upon reaching age 55, each vested member may retire and receive a monthly pension equal to his vested percent multiplied by six times the governing body's average monthly contribution over the member's years of qualified service. For years of service in excess of 15 years, this monthly benefit is increased at the rate of 6.2% compounded annually. There is no provision for automatic post-retirement benefit increases.

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

B. Funding Policy

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

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

The board rule defining contributions was amended effective July 27, 2014 to add the potential for actuarially determined Part Two contributions that would be required only if the expected future annual contributions from the state are not enough with the Part One contributions to provide an adequate contribution arrangement as determined by the most recent actuarial valuation. This Part Two portion, which is actuarially determined as a percent of the Part One portion (not to exceed 15%), is to be actuarially adjusted near the end of each even-numbered calendar year based on the most recent actuarial valuation. Based on the actuarial valuation as of August 31, 2014, the Part Two contribution rate was 0%, since the fir actuarial valuation report after adoption of the rules showed the System to have an adequate contribution arrangement without any Part Two contributions.

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

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

**NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM – (Continued)**

C. Contributions Required and Contributions Made

The contribution requirement per active emergency services personnel member per month is not actuarially determined. Rather, the minimum contribution provisions were set by board rule, and there is no maximum contribution rate. For the fiscal year ending August 31, 2014, total contributions (dues, prior service and interest on prior service financing) of \$4,176,659 were paid into TESRS by the political subdivisions served by the member volunteer emergency services personnel. The State appropriated \$1,530,343 for the fiscal year ended August 31, 2014.

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

The actuarial valuation as of August 31, 2014 stated that TESRS has an adequate contribution arrangement for the benefit provisions recognized in the valuation based on the expected total contributions, including the expected contributions both from the governing body of each participating department and from the state. The expected contributions from the state are state appropriations equal to (1) the maximum annual contribution (one-third of all contributions to TESRS by governing bodies of participating departments in a year) as needed in accordance with state law governing TESRS and (2) approximately \$625,000 each year to pay for part of the System's administrative expenses. On August 31, 2014 the actuarial liabilities exceeded the actuarial assets by \$26,093,761.

D. Actuarial Assumptions

The total pension liability in the August 31, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.50%
Salary increases	N/A
Investment rate of return	7.75%, net of pension plan investment expense, including inflation.

Mortality rates were based on the RP-2000 Combined Healthy Lives Mortality Tables for males and for females projected to 2018 by scale AA.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future net real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These components are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation (3.50%). In addition, the final 7.75% assumption reflected a reduction of 0.20% for adverse deviation. The target allocation and expected arithmetic real rates of return for each major asset class are summarized in the following table:

**NOTE 7: TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM – (Continued)**

Asset Class	Target Allocation	Long-Term Expected Net Real Rate of Return
Equities		
Large cap domestic	32%	5.2%
Small cap domestic	10%	5.8%
Developed international	21%	5.5%
Emerging markets	6%	5.4%
Master limited partnership	5%	7.1%
Fixed income		
Domestic	21%	1.4%
International	5%	1.6%
Cash	0%	0.0%
Total	100%	

**Schedule of Funding Progress**

Actuarial Valuation Date	Actuarial Value of Assets a	Actuarial Liability (AAL) - Entry Age b	Unfunded AAL (UAAL) b - a	Funded Ratio a/b	Total Members Covered c	UAAL Per Member Covered (b-a)/c
8/31/2010	\$ 64,113,803	\$ 81,264,230	\$ 17,150,427	78.9%	\$ 8,644	\$ 1,984
8/31/2012	67,987,487	101,856,042	33,868,555	66.7%	9,448	3,585
8/31/2014	83,761,038	109,854,799	26,093,761	76.2%	9,270	2,815

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Actuarial assumptions and methods of the latest valuation follows:

Valuation date	August 31, 2014
Actuarial cost method	Entry Age
Amortization method	Level dollar, open
Amortization period	30 years
Asset valuation method	Market value smoothed by a 5 year deferred recognition method with a 80%/120% corridor on market value

Actuarial assumptions:

Investment rate of return	7.75% per year, net of investment expenses
Projected salary increases	N/A
Includes inflation at	3.50%
Cost of living adjustments	None



**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 1<sup>st</sup> of any year to be effective the following January 1<sup>st</sup>.

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

**NOTE 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, 2014, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<b>Governmental activities</b>					
Tax notes	\$ 84,200	\$ -	\$ 41,100	\$ 43,100	\$ 43,100
Compensated absences	22,996	6,323	-	29,319	29,319
Equipment notes	92,854	-	25,187	67,667	26,431
Total governmental activity long-term liabilities	<u>\$ 200,050</u>	<u>\$ 6,323</u>	<u>\$ 66,287</u>	<u>\$ 140,086</u>	<u>\$ 98,850</u>
<b>Business-type activities</b>					
General obligation bonds	\$ 145,000	\$ -	\$ 145,000	\$ -	\$ -
Certificates of obligation	3,580,000	-	180,000	3,400,000	180,000
Issuance premium	617,638	-	88,234	529,404	88,234
Compensated absences	5,024	6,322	-	11,346	11,346
Payable to developer	1,144,076	-	91,889	1,052,187	50,000
Total business-type activity long-term liabilities	<u>\$ 5,491,738</u>	<u>\$ 6,322</u>	<u>\$ 505,123</u>	<u>\$ 4,992,937</u>	<u>\$ 329,580</u>

**NOTE 10: LONG-TERM DEBT – (Continued)**

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

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

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

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

	<u>Term</u>	<u>Interest Rate</u>	<u>Original Amount</u>
Series 2004	2004 - 2014	1.50% - 3.80%	\$ 1,545,000
Series 2011	2011 - 2031	2.00% - 4.375%	\$ 3,580,000

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

<u>Year</u>	<u>Business-type Activities</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2015	\$ 180,000	\$ 128,300	\$ 308,300
2016	185,000	123,800	308,800
2017-2021	1,025,000	528,225	1,553,225
2022-2026	905,000	344,100	1,249,100
2027-2031	1,105,000	145,500	1,250,500
	-	-	-
	<u>\$ 3,400,000</u>	<u>\$ 1,269,925</u>	<u>\$ 4,669,925</u>

**C. Tax Notes**

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

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

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>	
2015	43,100	1,832	44,932
	<u>\$ 43,100</u>	<u>\$ 1,832</u>	<u>\$ 44,932</u>

**NOTE 10: LONG-TERM DEBT – (Continued)**

D. Equipment Notes

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

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	26,431	2,749	29,180
2016	27,742	1,438	29,180
2017	<u>13,494</u>	<u>438</u>	<u>13,932</u>
Totals	<u><u>67,667</u></u>	<u><u>4,625</u></u>	<u><u>72,292</u></u>

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

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	72,827	15,406	88,233
2016	75,194	13,040	88,234
2017	77,638	10,596	88,234
2018	80,161	8,073	88,234
2019	82,767	5,467	88,234
2020	<u>85,457</u>	<u>2,777</u>	<u>88,234</u>
	<u><u>474,044</u></u>	<u><u>55,359</u></u>	<u><u>529,403</u></u>

E. Payable to Developer

In 2005, the City entered into a reimbursement contract with a land development company that was anticipating purchasing property for the development of a residential subdivision. The amount of the reimbursement was based on the amount spent on certain infrastructure improvements incurred in the development of the subdivision. The total expense incurred by the developer amounted to \$1,405,101. The City has agreed to pay the developer 75% of the property taxes collected based on a formula agreed upon by the parties. The City will continue to pay the developer on an annual basis until 100% of the \$1,405,101 has been repaid. The City has made payments of \$66,982, \$87,154, \$50,017, \$32,785, \$24,807 and \$91,889 for the 2009, 2010, 2011, 2012, 2013 and 2014 fiscal years, respectively. The City has recorded the net liability of \$1,052,187 in the accompanying financial statements. There is no predetermined repayment schedule since the amounts paid annually depend on the amount of taxes collected on certain properties. The accompanying financial statements reflect an estimated current portion of \$50,000.

**NOTE 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 2014, were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Airport	\$ 5,977
	Water and Sewer	\$ 46,723
	HOME	\$ 5,465
	Seizure	<u>137</u>
		<u>\$ 58,302</u>

B. Interfund Transfers

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

<u>Transfers Out</u>	<u>Transfers In</u>			
	<u>General Fund</u>	<u>Equipment Fund</u>	<u>Nonmajor Governmental</u>	<u>Total</u>
General	\$ -	\$ 70,000	\$ -	\$ 70,000
Nonmajor Governmental	5,002	-	-	5,002
Water and Sewer	58,711	135,000	31,225	224,936
Airport	<u>-</u>	<u>1,500</u>	<u>-</u>	<u>1,500</u>
	<u>\$ 63,713</u>	<u>\$ 206,500</u>	<u>\$ 31,225</u>	<u>\$ 301,438</u>

**NOTE 12: COMMITMENTS AND CONTINGENCIES**

Grant Programs

The City participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable at September 30, 2014, 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: FUND BALANCES**

The following is a detail of the governmental fund balances as of September 30, 2014:

	Governmental Fund Balances			Total
	<u>Nonspendable</u>	<u>Restricted</u>	<u>Unassigned</u>	
General				
Inventory	\$ 9,671	\$ -	\$ -	\$ 9,671
Unassigned	-	-	697,086	697,086
Nonmajor Governmental				
Retirement of long-term debt	-	70,384	-	70,384
Municipal court	-	30,494	-	30,494
State and federal grant programs	-	(7,103)	-	(7,103)
Public safety	-	15,744	-	15,744
Tourism	-	41,659	-	41,659
	<u>\$ 9,671</u>	<u>\$ 151,178</u>	<u>\$ 697,086</u>	<u>\$ 857,935</u>

**NOTE 14: RESTATEMENT OF NET FUND BALANCE**

The beginning fund balance of the General Fund was restated to reflect prior year that was not recorded in the prior year. The result of this restatement was a decrease of \$8,778 to capital assets and invested in capital assets. The 2013 amounts were changed for comparative purposes.

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## **REQUIRED SUPPLEMENTARY INFORMATION**

**CITY OF PALACIOS, TEXAS**

## MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

## SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

## BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2014

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
<b>REVENUES</b>				
Taxes				
Ad valorem taxes	\$ 1,365,780	\$ 1,365,780	\$ 1,339,860	\$ (25,920)
Other taxes	645,052	645,052	660,805	15,753
Licenses and permits	28,270	28,270	32,885	4,615
Intergovernmental	24,368	24,368	24,121	(247)
Charges for services	-	-	-	-
Fines and forfeitures	65,000	65,000	76,538	11,538
Investment income	1,650	1,650	1,526	(124)
Miscellaneous	135,228	135,228	129,419	(5,809)
<b>Total revenues</b>	<u>2,265,348</u>	<u>2,265,348</u>	<u>2,265,154</u>	<u>(194)</u>
<b>EXPENDITURES</b>				
Current				
General government	674,789	674,789	557,597	117,192
Public safety	1,086,200	1,086,200	1,146,356	(60,156)
Public works	423,660	423,660	391,552	32,108
Special services	150,145	150,145	98,182	51,963
Health and welfare	57,406	57,406	51,792	5,614
Debt service	-	-	-	-
<b>Total expenditures</b>	<u>2,392,200</u>	<u>2,392,200</u>	<u>2,245,479</u>	<u>146,721</u>
Excess (deficiency) of revenues over expenditures	(126,852)	(126,852)	19,675	146,527
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	158,600	158,600	155,602	(2,998)
Transfers out	(70,000)	(70,000)	(161,889)	(91,889)
<b>Total other financing sources (uses)</b>	<u>88,600</u>	<u>88,600</u>	<u>(6,287)</u>	<u>(94,887)</u>
Net change in fund balance	(38,252)	(38,252)	13,388	51,640
Fund balance at beginning of year	<u>693,369</u>	<u>693,369</u>	<u>693,369</u>	<u>-</u>
<b>Fund balance at end of year</b>	<u>\$ 655,117</u>	<u>\$ 655,117</u>	<u>\$ 706,757</u>	<u>\$ 51,640</u>

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



**TEXAS MUNICIPAL RETIREMENT SYSTEM**

The schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability of benefits.

Schedule of Funding Status

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2012	\$ 2,842,932	\$ 4,212,867	\$ 1,369,935	67.5%	\$ 1,490,464	91.9%

**TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM**

Valuation date	August 31, 2014
Actuarial cost method	Entry Age
Amortization method	Level dollar, open
Amortization period	30 years
Asset valuation method	Market value smoothed by a 5 year deferred recognition method with a 80%/120% corridor on market value
Actuarial assumptions:	
Investment rate of return	7.75% per year, net of investment expenses
Projected salary increases	N/A
Includes inflation at	3.50%
Cost of living adjustments	None

**CITY OF PALACIOS, TEXAS**  
**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**  
*September 30, 2014*

**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, 2014 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>
Police	\$1,051,000	\$1,111,497	\$ (59,997)
Fire Department	\$ 34,700	\$ 34,859	\$ (159)

**COMBINING AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES**

**CITY OF PALACIOS, TEXAS**  
 NONMAJOR GOVERNMENTAL FUNDS  
 COMBINING BALANCE SHEET  
 September 30, 2014

	Special Revenue Funds			
	Police Seized Drug	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
<b>ASSETS</b>				
Cash and cash equivalents	\$ -	\$ 35,773	\$ -	\$ 2,824
Receivables (net)				
Taxes	-	5,886	-	-
Other	-	-	139	-
Due from other funds	-	-	-	-
<b>Total assets</b>	<u>\$ -</u>	<u>\$ 41,659</u>	<u>\$ 139</u>	<u>\$ 2,824</u>
<b>LIABILITIES AND FUND BALANCES</b>				
Liabilities				
Accounts payable	\$ -	\$ -	\$ -	\$ -
Due to other funds	-	-	139	-
Deferred revenue	-	-	-	-
Due to other governments	-	-	-	-
<b>Total liabilities</b>	<u>-</u>	<u>-</u>	<u>139</u>	<u>-</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
Unearned revenues	-	-	-	-
<b>Total Deferred Inflows of Resources</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances				
Restricted				
Public safety	-	-	-	-
Tourism	-	41,659	-	-
State and federal grant programs	-	-	-	2,824
Municipal court	-	-	-	-
Debt service	-	-	-	-
<b>Total fund balances</b>	<u>-</u>	<u>41,659</u>	<u>-</u>	<u>2,824</u>
<b>Total liabilities and fund balances</b>	<u>\$ -</u>	<u>\$ 41,659</u>	<u>\$ 139</u>	<u>\$ 2,824</u>

Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency	Safe School Bridge
\$ 720	\$ 15,648	\$ 14,846	\$ 25,804	\$ 1,581	\$ -
-	-	-	-	-	-
138	-	-	138	-	-
-	-	-	-	-	-
<u>\$ 858</u>	<u>\$ 15,648</u>	<u>\$ 14,846</u>	<u>\$ 25,942</u>	<u>\$ 1,581</u>	<u>\$ -</u>
\$ 6,821	\$ -	\$ -	\$ -	\$ -	\$ -
5,464	-	-	138	-	-
-	-	-	-	-	-
-	-	-	11,641	-	-
<u>12,285</u>	<u>-</u>	<u>-</u>	<u>11,779</u>	<u>-</u>	<u>-</u>
-	-	-	-	-	-
-	-	-	14,163	1,581	-
-	-	-	-	-	-
(11,427)	-	-	-	-	-
-	15,648	14,846	-	-	-
-	-	-	-	-	-
<u>(11,427)</u>	<u>15,648</u>	<u>14,846</u>	<u>14,163</u>	<u>1,581</u>	<u>-</u>
<u>\$ 858</u>	<u>\$ 15,648</u>	<u>\$ 14,846</u>	<u>\$ 25,942</u>	<u>\$ 1,581</u>	<u>\$ -</u>

(continued)

**CITY OF PALACIOS, TEXAS**  
**NONMAJOR GOVERNMENTAL FUNDS**  
**COMBINING BALANCE SHEET**  
September 30, 2014

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	Disaster Recovery Fund	Debt Service Fund
<b>ASSETS</b>		
Cash and cash equivalents	\$ 1,500	\$ 70,295
Receivables (net)		
Taxes	-	4,208
Other	138	89
Due from other funds	-	-
<b>Total assets</b>	<u>\$ 1,638</u>	<u>\$ 74,592</u>
<b>LIABILITIES AND FUND BALANCES</b>		
Liabilities		
Accounts payable	\$ -	\$ -
Due to other funds	138	-
Deferred revenue	-	-
Due to other governments	-	-
<b>Total liabilities</b>	<u>138</u>	<u>-</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unearned revenues	-	4,208
<b>Total Deferred Inflows of Resources</b>	<u>-</u>	<u>4,208</u>
Fund balances		
Restricted		
Public safety	-	-
Tourism	-	-
State and federal grant programs	1,500	-
Municipal court	-	-
Debt service	-	70,384
<b>Total fund balances</b>	<u>1,500</u>	<u>70,384</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,638</u>	<u>\$ 74,592</u>

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**CITY OF PALACIOS, TEXAS**

NONMAJOR GOVERNMENTAL FUNDS

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

For the year ended September 30, 2014

	Special Revenue Funds			
	Police Seized Drug	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
<b>REVENUES</b>				
Taxes				
Hotel - motel tax	\$ -	\$ 39,340	\$ -	\$ -
Ad valorem taxes	-	-	-	-
Court fees	-	-	-	-
Intergovernmental	-	-	-	112,892
Investment income				
Interest	-	70	-	12
Miscellaneous	-	-	-	-
<b>Total revenues</b>	<u>-</u>	<u>39,410</u>	<u>-</u>	<u>112,904</u>
<b>EXPENDITURES</b>				
Current				
General government				
Promotional expense	-	9,040	-	-
Public works	-	-	-	113,272
Principal				
Interest	-	-	-	-
<b>Total expenditures</b>	<u>-</u>	<u>9,040</u>	<u>-</u>	<u>113,272</u>
Excess (deficiency) of revenues over expenditures	-	30,370	-	(368)
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in (out)	-	(5,000)	31,225	-
<b>Total other financing sources (uses)</b>	<u>-</u>	<u>(5,000)</u>	<u>31,225</u>	<u>-</u>
Net change in fund balances	-	25,370	31,225	(368)
Fund balances at beginning of year	-	16,289	(31,225)	3,192
<b>Fund balances at end of year</b>	<u>\$ -</u>	<u>\$ 41,659</u>	<u>\$ -</u>	<u>\$ 2,824</u>



Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency	Safe School Bridge
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	-	-	-
-	2,270	1,702	-	212	-
170,244	-	-	-	-	-
-	50	47	107	5	-
-	-	-	40,000	-	-
<u>170,244</u>	<u>2,320</u>	<u>1,749</u>	<u>40,107</u>	<u>217</u>	<u>-</u>
-	-	-	30,839	-	-
181,671	679	-	-	-	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>181,671</u>	<u>679</u>	<u>-</u>	<u>30,839</u>	<u>-</u>	<u>-</u>
(11,427)	1,641	1,749	9,268	217	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2)</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2)</u>
(11,427)	1,641	1,749	9,268	217	(2)
-	14,007	13,097	4,895	1,364	2
<u>\$ (11,427)</u>	<u>\$ 15,648</u>	<u>\$ 14,846</u>	<u>\$ 14,163</u>	<u>\$ 1,581</u>	<u>\$ -</u>

(continued)

**CITY OF PALACIOS, TEXAS****NONMAJOR GOVERNMENTAL FUNDS****COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**

For the year ended September 30, 2014

---

	Disaster Recovery Fund	Debt Service Fund	Total
<b>REVENUES</b>			
Taxes			
Hotel - motel tax	\$ -	\$ -	\$ 39,340
Ad valorem taxes	-	54,516	54,516
Court fees	-	-	4,184
Intergovernmental	1,278,332	-	1,561,468
Investment income			
Interest	-	11	302
Miscellaneous	-	-	40,000
<b>Total revenues</b>	<u>1,278,332</u>	<u>54,527</u>	<u>1,699,810</u>
<b>EXPENDITURES</b>			
Current			
General government			
Promotional expense	-	-	39,879
Public works	1,278,332	-	1,573,954
Principal	-	41,100	41,100
Interest	-	3,938	3,938
<b>Total expenditures</b>	<u>1,278,332</u>	<u>45,038</u>	<u>1,658,871</u>
Excess (deficiency) of revenues over expenditures	-	9,489	40,939
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers in (out)	-	-	26,223
<b>Total other financing sources (uses)</b>	<u>-</u>	<u>-</u>	<u>26,223</u>
Net change in fund balances	-	9,489	67,162
Fund balances at beginning of year	<u>1,500</u>	<u>60,895</u>	<u>84,016</u>
<b>Fund balances at end of year</b>	<u>\$ 1,500</u>	<u>\$ 70,384</u>	<u>\$ 151,178</u>

(concluded)

## **GENERAL FUND**

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

**CITY OF PALACIOS, TEXAS****MAJOR GOVERNMENTAL FUNDS - GENERAL FUND****BALANCE SHEET**

September 30, 2014

With comparative totals for September 30, 2013

---

	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 633,775	\$ 550,665
Receivables (net)		
Accounts	15,761	17,327
Taxes	361,955	369,285
Fines	72,492	71,508
Due from other governments	82,351	142,025
Due from other funds	58,302	62,691
Inventory	9,671	23,163
<b>Total assets</b>	<u>\$ 1,234,307</u>	<u>\$ 1,236,664</u>
<b>LIABILITIES AND FUND BALANCES</b>		
Liabilities		
Accounts payable	\$ 51,596	\$ 63,002
Accrued expenses	25,921	29,001
Due to other funds	-	-
Due to other governments	14,469	9,713
<b>Total liabilities</b>	<u>91,986</u>	<u>101,716</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unearned revenues	435,564	441,579
<b>Total Deferred Inflows of Resources</b>	<u>435,564</u>	<u>441,579</u>
Fund balances		
Nonspendable	9,671	23,163
Unassigned	697,086	670,206
<b>Total fund balances</b>	<u>706,757</u>	<u>693,369</u>
<b>Total liabilities and fund balances</b>	<u>\$ 1,234,307</u>	<u>\$ 1,236,664</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, 2014**With comparative totals for the year ended September 30, 2013*

	2014		Variance	2013
	Final Budget	Actual	Positive (Negative)	Actual
<b>REVENUES</b>				
Ad valorem taxes				
Current and delinquent taxes	\$ 1,317,280	\$ 1,283,131	\$ (34,149)	\$ 1,284,202
Penalty and interest	45,000	53,544	8,544	52,315
Tax certificates, other fees	3,500	3,185	(315)	590
Total ad valorem taxes	<u>1,365,780</u>	<u>1,339,860</u>	<u>(25,920)</u>	<u>1,337,107</u>
Other taxes				
Sales tax	330,000	341,861	11,861	443,146
Property tax reduction sales tax	165,000	171,197	6,197	221,344
Franchise tax	145,000	143,170	(1,830)	141,619
Bingo tax	500	25	(475)	63
Mixed beverage tax	4,552	4,552	-	3,238
Total other taxes	<u>645,052</u>	<u>660,805</u>	<u>15,753</u>	<u>809,410</u>
Licenses and permits				
Building and moving permits	16,500	21,355	4,855	16,532
Dog licenses	11,770	11,530	(240)	11,215
Total licenses and permits	<u>28,270</u>	<u>32,885</u>	<u>4,615</u>	<u>27,747</u>
Intergovernmental				
Grant proceeds	<u>24,368</u>	<u>24,121</u>	<u>(247)</u>	<u>62,803</u>
Charges for services				
Weedy lot mowing	-	-	-	-
Economic development	-	-	-	-
Total charges for services	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fines and forfeitures				
Fines and court costs	<u>65,000</u>	<u>76,538</u>	<u>11,538</u>	<u>80,094</u>
Investment income				
Interest	<u>1,650</u>	<u>1,526</u>	<u>(124)</u>	<u>1,031</u>
Miscellaneous				
Insurance reimbursement	20,336	20,774	438	27,092
Maintenance contract	65,377	65,377	-	117,438
Other	49,515	43,268	(6,247)	50,820
Total miscellaneous	<u>135,228</u>	<u>129,419</u>	<u>(5,809)</u>	<u>195,350</u>
<b>Total revenues</b>	<u>2,265,348</u>	<u>2,265,154</u>	<u>(194)</u>	<u>2,513,542</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, 2014

With comparative totals for the year ended September 30, 2013

	2014		Variance Positive (Negative)	2013
	Final Budget	Actual		Actual
<b>EXPENDITURES</b>				
<b>General government</b>				
Mayor and city council				
Salaries and wages	\$ 20,400	\$ 20,400	\$ -	\$ 20,350
Office supplies	1,400	1,200	200	1,297
Special services	1,945	1,945	-	434
Travel, training, and dues	3,700	2,342	1,358	3,416
Social security tax	1,650	1,653	(3)	1,649
Employee benefits	100	28	72	91
Capital outlay	-	-	-	-
Total mayor and city council	<u>29,195</u>	<u>27,568</u>	<u>1,627</u>	<u>27,237</u>
Elections				
Office supplies	1,494	1,494	-	888
Special services	850	849	1	-
Total elections	<u>2,344</u>	<u>2,343</u>	<u>1</u>	<u>888</u>
Administrative				
Salaries and wages	275,200	205,809	69,391	263,605
Office supplies	10,200	10,055	145	10,139
Maintenance - office equipment	26,060	29,058	(2,998)	19,626
Maintenance - buildings	10,700	10,649	51	48,421
Telephone	5,000	5,345	(345)	5,662
Electricity	4,000	3,426	574	3,571
Gas	480	426	54	328
Professional fees	12,750	12,194	556	12,600
Special services	40,800	37,220	3,580	36,758
Travel, training, and dues	9,460	8,082	1,378	9,390
Social security tax	22,500	15,753	6,747	20,602
Employee benefits	96,500	67,955	28,545	79,001
Capital outlay	-	-	-	-
Total administrative	<u>513,650</u>	<u>405,972</u>	<u>107,678</u>	<u>509,703</u>
Legal				
Special services	<u>11,000</u>	<u>4,253</u>	<u>6,747</u>	<u>7,745</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, 2014

With comparative totals for the year ended September 30, 2013

	2014		Variance Positive (Negative)	2013
	Final Budget	Actual		Actual
<b>EXPENDITURES - (CONTINUED)</b>				
<b>General government - (continued)</b>				
Corporation court				
Salaries and wages	\$ 63,480	\$ 64,437	\$ (957)	\$ 63,316
Office supplies	300	281	19	505
Maintenance - office equipment	4,490	4,402	88	4,304
Telephone	80	43	37	550
Special services	900	60	840	720
Travel, training, and dues	1,500	619	881	2,126
Social security tax	5,000	4,887	113	4,815
Employee benefits	12,850	12,732	118	12,270
Capital outlay	-	-	-	-
Total corporation court	<u>88,600</u>	<u>87,461</u>	<u>1,139</u>	<u>88,606</u>
Library				
Special services	<u>30,000</u>	<u>30,000</u>	<u>-</u>	<u>29,000</u>
Total general government	<u>674,789</u>	<u>557,597</u>	<u>117,192</u>	<u>663,179</u>
<b>Public safety</b>				
Police department				
Salaries and wages	696,600	758,908	(62,308)	773,527
Minor tools	5,100	5,178	(78)	4,300
Office supplies	5,000	3,788	1,212	4,805
Clothing	3,100	3,046	54	3,834
Maintenance - buildings	1,270	1,303	(33)	-
Maintenance - radios/radar	27,900	27,386	514	-
Maintenance - office equipment	7,400	6,126	1,274	32,885
Telephone, electricity, and gas	17,110	16,653	457	23,924
Special services	2,600	2,066	534	3,387
Travel, training, and dues	7,900	4,357	3,543	6,065
Support of prisoners	700	329	371	614
Social security tax	54,320	58,072	(3,752)	59,145
Employee benefits	222,500	224,285	(1,785)	223,845
Capital outlay	-	-	-	9,368
Total police department	<u>1,051,500</u>	<u>1,111,497</u>	<u>(59,997)</u>	<u>1,145,699</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, 2014

With comparative totals for the year ended September 30, 2013

	2014			2013
	Final Budget	Actual	Variance Positive (Negative)	Actual
<b>EXPENDITURES - (CONTINUED)</b>				
<b>Public safety - (continued)</b>				
Fire department				
Supplies	\$ 8,700	\$ 8,136	\$ 564	\$ 954
Chemicals	200	-	200	-
Maintenance - equipment	-	125	(125)	-
Maintenance - buildings	1,000	269	731	-
Maintenance - radios	-	-	-	-
Telephone	1,100	1,169	(69)	1,118
Electricity	1,000	1,238	(238)	1,072
Gas	300	338	(38)	303
Travel, training, and dues	800	-	800	-
Special services	4,000	2,670	1,330	3,227
Employee benefits	17,600	20,914	(3,314)	18,431
Capital outlay	-	-	-	12,438
Total fire department	<u>34,700</u>	<u>34,859</u>	<u>(159)</u>	<u>37,543</u>
Total public safety	<u>1,086,200</u>	<u>1,146,356</u>	<u>(60,156)</u>	<u>1,183,242</u>
<b>Public works</b>				
Park maintenance				
Salaries	29,210	28,840	370	30,058
Tools and supplies	9,300	10,032	(732)	6,269
Chemicals	1,000	140	860	-
Reconstruction materials	-	-	-	-
Electricity	20,000	19,453	547	20,498
Special services	113,200	104,549	8,651	119,277
Employee Benefit	15,310	14,284	1,026	15,398
Capital outlay	<u>39,130</u>	<u>39,281</u>	<u>(151)</u>	<u>67,982</u>
Total park maintenance	<u>227,150</u>	<u>216,579</u>	<u>10,571</u>	<u>259,482</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, 2014

With comparative totals for the year ended September 30, 2013

	2014		Variance	2013
	Final		Positive	
	Budget	Actual	(Negative)	Actual
<b>Public works - (continued)</b>				
Streets				
Salaries and wages	\$ 29,650	\$ 22,826	\$ 6,824	\$ 27,250
Tools and supplies	6,500	19,451	(12,951)	48
Chemicals	1,500	1,513	(13)	-
Clothing	200	156	44	155
Maintenance - radios	100	-	100	-
Reconstruction materials	27,550	28,889	(1,339)	5,136
Pipe and culverts	17,600	17,587	13	7,677
Electricity	45,000	38,912	6,088	47,490
Special services	37,000	34,335	2,665	9,481
Social security tax	2,230	1,772	458	2,078
Employee benefits	11,730	9,532	2,198	11,033
Capital outlay	17,450	-	17,450	49,902
Total streets	196,510	174,973	21,537	160,250
Total public works	423,660	391,552	32,108	419,732
<b>Health and welfare</b>				
Animal control				
Supplies	6,981	6,351	630	6,869
Telephone	800	701	99	753
Electricity	1,200	1,265	(65)	1,302
Special services	1,000	635	365	780
Travel, training, and dues	500	436	64	441
Capital outlay	-	-	-	-
Total animal control	10,481	9,388	1,093	10,145
Recycling center				
Salaries and wages	25,080	22,500	2,580	24,740
Tools and supplies	1,925	1,351	574	2,557
Telephone	700	748	(48)	742
Electricity	900	793	107	911
Special services	2,825	2,809	16	2,717
Travel, training, and dues	1,145	1,024	121	740
Social security tax	1,920	1,726	194	1,843
Employee benefits	12,430	11,453	977	11,528
	-	-	-	21,060
Total recycling center	46,925	42,404	4,521	66,838
Total health and welfare	57,406	51,792	5,614	76,983

**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, 2014

With comparative totals for the year ended September 30, 2013

	2014		Variance Positive (Negative)	2013
	Final Budget	Actual		Actual
<b>EXPENDITURES - (CONTINUED)</b>				
<b>Special services</b>				
Unemployment	\$ 12,000	\$ 10,247	\$ 1,753	\$ 4,292
Note principal	-	-	-	-
Note interest	-	-	-	-
Hospital assistance	10,000	10,000	-	10,000
Development agreement rebate	56,680	6,674	50,006	24,087
Insurance and bonds	70,465	70,463	2	67,974
Community improvements	1,000	798	202	1,335
<b>Total special services</b>	<u>150,145</u>	<u>98,182</u>	<u>51,963</u>	<u>107,688</u>
<b>Total expenditures</b>	<u>2,392,200</u>	<u>2,245,479</u>	<u>146,721</u>	<u>2,450,824</u>
Excess (deficiency) of revenues over expenditures	(126,852)	19,675	146,527	62,718
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	158,600	155,602	(2,998)	100,625
Transfers out	<u>(70,000)</u>	<u>(161,889)</u>	<u>(91,889)</u>	<u>(76,000)</u>
<b>Total other financing sources (uses)</b>	<u>88,600</u>	<u>(6,287)</u>	<u>(94,887)</u>	<u>24,625</u>
Net change in fund balance	(38,252)	13,388	51,640	87,343
Fund balance (as restated) at beginning of year	<u>693,369</u>	<u>693,369</u>	-	<u>606,026</u>
<b>Fund balance at end of year</b>	<u>\$ 655,117</u>	<u>\$ 706,757</u>	<u>\$ 51,640</u>	<u>\$ 693,369</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 revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. All activities necessary to provide services are accounted for in these funds, including, but not limited to, administration, operations, and maintenance. Debt service amounts are also included.

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

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

**CITY OF PALACIOS, TEXAS***MAJOR ENTERPRISE FUND - WATER AND SEWER FUND**STATEMENT OF NET POSITION**September 30, 2014**With comparative totals for September 30, 2013*

	2014	2013
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 270,848	\$ 446,180
Receivables		
Accounts	452,249	460,339
Other	1,532	538
Allowance for uncollectible accounts	(165,124)	(178,620)
Due from other funds	277	-
Inventory	76,857	93,530
Total current assets	<u>636,639</u>	<u>821,967</u>
Noncurrent assets		
Capital assets		
Office equipment and furniture	47,715	47,715
Machinery and equipment	940,402	997,935
Service delivery system	21,574,643	17,774,475
Buildings and fixtures	3,404,639	3,404,639
Land structured facilities	760,184	760,184
Total capital assets	26,727,583	22,984,948
Accumulated depreciation	(9,189,632)	(8,485,601)
Subtotal	17,537,951	14,499,347
Land	8,129	8,129
Construction in progress	1,278,332	3,627,998
Net capital assets	<u>18,824,412</u>	<u>18,135,474</u>
Deferred expenses (net)	45,730	62,052
Total noncurrent capital assets	<u>18,870,142</u>	<u>18,197,526</u>
<b>Total assets</b>	<u>19,506,781</u>	<u>19,019,493</u>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable	77,672	135,740
Accrued expenses	8,001	7,914
Due to other funds	46,723	46,723
Accrued interest payable	16,038	17,176
Customer meter deposits	115,344	113,829
Accrued compensated absences	11,346	5,024
Current portion of payable to developer	50,000	35,000
Current portion of general obligation bonds	180,000	325,000
Current portion of notes	88,234	88,234
Total current liabilities	<u>593,358</u>	<u>774,640</u>
Noncurrent liabilities		
Notes payable	441,169	529,404
General obligation bonds	-	-
Certificates of obligation	3,220,000	3,400,000
Payable to developer	1,002,187	1,109,076
Total noncurrent liabilities	<u>4,663,356</u>	<u>5,038,480</u>
<b>Total liabilities</b>	<u>5,256,714</u>	<u>5,813,120</u>
<b>NET POSITION</b>		
Invested in capital assets, net of related debt	13,872,514	12,767,010
Unrestricted	377,553	439,363
<b>Total net position</b>	<u>\$ 14,250,067</u>	<u>\$ 13,206,373</u>

**CITY OF PALACIOS, TEXAS**

MAJOR ENTERPRISE FUND - WATER AND SEWER FUND

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

For the year ended September 30, 2014

With comparative totals for the year ended September 30, 2013

---

	<u>2014</u>	<u>2013</u>
<b>OPERATING REVENUES</b>		
Charges for services	\$ 1,781,690	\$ 1,841,949
<b>OPERATING EXPENSES</b>		
Water system	645,617	623,367
Sanitary sewer system	282,086	256,938
Solid waste	-	-
Miscellaneous	19,654	17,450
Depreciation	704,031	562,682
Amortization	-	-
<b>Total operating expenses</b>	<u>1,651,388</u>	<u>1,460,436</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	130,302	381,513
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income		
Interest	1,114	2,688
Connection fees	6,300	11,300
Miscellaneous income (expense)	2,420	1,835
Interest and fiscal charges	<u>(149,838)</u>	<u>(150,559)</u>
<b>Total nonoperating revenues (expenses)</b>	<u>(140,004)</u>	<u>(134,736)</u>
Income (loss) before contributions and transfers	(9,702)	246,777
Contributions and transfers		
Capital contributions	1,278,332	24,087
Transfers out	(316,825)	-
Transfers in	<u>91,889</u>	<u>(233,625)</u>
Total contributions and transfers	<u>1,053,396</u>	<u>(209,538)</u>
Change in net position	1,043,694	37,239
Total net position at beginning of year	<u>13,206,373</u>	<u>13,169,134</u>
<b>Total net position at end of year</b>	<u>\$ 14,250,067</u>	<u>\$ 13,206,373</u>

**CITY OF PALACIOS, TEXAS**

*MAJOR ENTERPRISE FUND - AIRPORT FUND*

*STATEMENT OF NET POSITION*

*September 30, 2014*

*With comparative totals for September 30, 2013*

---

	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	725	13,332
Inventory	<u>22,189</u>	<u>41,802</u>
Total current assets	<u>22,914</u>	<u>55,134</u>
Noncurrent assets		
Capital assets		
Machinery and equipment	85,462	85,462
Buildings and fixtures	66,479	117,979
Land structured facilities	<u>1,581,337</u>	<u>1,394,215</u>
Total capital assets	1,733,278	1,597,656
Accumulated depreciation	<u>(431,571)</u>	<u>(385,422)</u>
Subtotal	<u>1,301,707</u>	<u>1,212,234</u>
Construction in progress	-	-
Net capital assets	<u>1,301,707</u>	<u>1,212,234</u>
<b>Total assets</b>	<u>1,324,621</u>	<u>1,267,368</u>
<b>LIABILITIES</b>		
Accounts payable	1,034	15,065
Due to other funds	<u>5,977</u>	<u>15,968</u>
<b>Total liabilities</b>	<u>7,011</u>	<u>31,033</u>
<b>NET POSITION</b>		
Invested in capital assets	1,301,707	1,212,234
Unrestricted	<u>15,903</u>	<u>24,101</u>
<b>Total net position</b>	<u>\$ 1,317,610</u>	<u>\$ 1,236,335</u>

**CITY OF PALACIOS, TEXAS***MAJOR ENTERPRISE FUND - AIRPORT FUND**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**For the year ended September 30, 2014**With comparative totals for the year ended September 30, 2013*

---

	<u>2014</u>	<u>2013</u>
<b>OPERATING REVENUES</b>		
Charges for services	\$ 20,920	\$ 18,643
Rental income	<u>12,027</u>	<u>28,616</u>
<b>Total operating revenues</b>	<u>32,947</u>	<u>47,259</u>
<b>OPERATING EXPENSES</b>		
Airport expenses		
Supplies	20,303	21,103
Repairs and maintenance	800	1,103
Utilities	11,994	9,703
Insurance and bonds	14,040	12,914
Special items	20,473	34,847
Depreciation	<u>46,149</u>	<u>41,536</u>
<b>Total operating expenses</b>	<u>113,759</u>	<u>121,206</u>
Operating income (loss) before nonoperating revenues (expenses) and transfers	(80,812)	(73,947)
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income		
Interest	1	100
Miscellaneous income (expense)	129,749	27,890
Nonoperating lease income	<u>33,837</u>	<u>23,637</u>
<b>Total nonoperating revenues (expenses)</b>	<u>163,587</u>	<u>51,627</u>
Income (loss) before transfers	82,775	(22,320)
Transfers		
Transfer out	<u>(1,500)</u>	<u>(5,000)</u>
Total transfers	<u>(1,500)</u>	<u>(5,000)</u>
Change in net position	81,275	(27,320)
Total net position at beginning of year	<u>1,236,335</u>	<u>1,263,655</u>
<b>Total net position at end of year</b>	<u>\$ 1,317,610</u>	<u>\$ 1,236,335</u>

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



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

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

To the City Council  
City of Palacios, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Palacios, Texas, as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise City of Palacios, Texas' basic financial statements, and have issued our report thereon dated February 18, 2015.

**Internal Control over Financial Reporting**

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

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

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

**Compliance and Other Matters**

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

**Purpose of this Report**

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

***Baker, Stogner & Associates***  
February 18, 2015

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

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El Campo, TX 77437

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the City Council  
City of Palacios, Texas

**Report on Compliance for Each Major Federal Program**

We have audited City of Palacios, Texas' compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of City of Palacios, Texas's major federal programs for the year ended September 30, 2014. City of Palacios, Texas's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of City of Palacios, Texas' major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Palacios, Texas' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of City of Palacios, Texas' compliance.

***Opinion on Each Major Federal Program***

In our opinion, City of Palacios, Texas, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2014.

***Other Matters***

The results of our auditing procedures disclosed no instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which would be described in the accompanying schedule of findings and questioned costs. Our opinion on each major federal program is not modified with respect to these matters.

**Report on Internal Control over Compliance**

Management of City of Palacios, Texas, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered City of Palacios, Texas' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over

compliance. Accordingly, we do not express an opinion on the effectiveness of City of Palacios, Texas' internal control over compliance.

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

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Baker, Stegner & Associates*

El Campo, Texas  
February 18, 2015

**CITY OF PALACIOS, TEXAS**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS**  
For the Year Ended September 30, 2014

**FEDERAL**

	Federal CFDA or State Number	Pass-through Entity Number	Federal Expenditures
U.S. Fish & Wildlife Service Coastal Impact Assistance Program	15.668	F13AF0080	\$ 113,272
US Department of Housing and Urban Development Pass through: GLO CDBG Rd 2.2	14.228	12-481-000-6647	1,278,332
Pass-thru Texas Department of Housing & Community Affairs HOME	14.239	1001425 1002115 1001851	174,472 2,550 2,778
Total HOME			<u>179,800</u>
Total Expenditure of Federal Awards			<u>\$ 1,571,404</u>

**STATE**

HGAC - Solid Waste Program		14-16-802	\$ 23,750
Texas Department of Transportation Assisted Airport Routine Maintenance	TXDot CSJ	M1413PALC	6,358
Airport Project Participation	TXDot CSJ	1313PALCS	120,335
Total Expenditures of State Awards			<u>\$ 150,443</u>

## **CITY OF PALACIOS, TEXAS**

### **NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS**

*For the Year Ended September 30, 2014*

#### **NOTE 1: BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal and state awards (the Schedule) includes the federal and state activity of the City of Palacios, Texas (the City) under programs of the federal and state governments for the year ended September 30, 2014. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget, OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the State of Texas Uniform Grant Management Standards *Chapter IV Texas State Audit Circular*. Because the schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net position or cash flows of the City.

#### **NOTE 2: BASIS OF ACCOUNTING**

The City accounts for all awards under programs of the federal and state governments in the General and Special Revenue Funds. These programs are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e. revenues and other financing sources) and decreases (i.e. expenditures and other financing uses) in net current assets.

The modified accrual basis of accounting is used for these funds. The basis of accounting recognizes revenues in the accounting period in which they become susceptible to accrual, i.e. both measurable, and available, and expenditures in the accounting period in which the liability is incurred, if measurable, except for certain compensated absences and claims and judgments, which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Federal and state grant funds for governmental funds are considered to be earned to the extent of expenditures made under the provisions of the grant. When such funds are advanced to the City, they are recorded as inflows or outflows until earned. Otherwise, federal and state grant funds are received on a reimbursement basis from the respective federal or state program agencies. Generally, unused balances are returned to the grantor at the close of the specified project periods.

# CITY OF PALACIOS, TEXAS

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the Year Ended September 30, 2014

### Section I - Summary of Auditor's Results

#### *Financial Statements*

Types of auditor's report issued: Unqualified

Internal control over financial reporting:

a. Material weakness(es) identified? No

b. Significant deficiency(ies) identified that are not considered to be material weakness(es)? No

Noncompliance material to the financial statements noted? N/A

#### *Federal Awards*

Internal control over major programs:

a. Material weakness(es) identified? No

b. Significant deficiency(ies) identified that are not considered to be material weakness(es)? No

Type of auditor's issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? No

#### **CFDA Numbers**

14.228

#### **Name of Federal Program or Cluster**

CDBG 2.2

Dollar threshold used to distinguish between type A and type B Programs

\$500,000

Auditee qualified as low-risk auditee? No

**CITY OF PALACIOS, TEXAS**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
 For the Year Ended September 30, 2014

**Section I - Summary of Auditor's Results**

*Financial Statements*

Types of auditor's report issued:	Unqualified
Internal control over financial reporting:	
a. Material weakness(es) identified?	No
b. Significant deficiency(ies) identified that are not considered to be material weakness(es)?	No
Noncompliance material to the financial statements noted?	N/A

*State Awards*

Internal control over major programs:	
a. Material weakness(es) identified?	No
b. Significant deficiency(ies) identified that are not considered to be material weakness(es)?	No
Type of auditor's issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	No

<u>State Contract Numbers</u>	<u>Name of State Program or Cluster</u>
Dollar threshold used to distinguish between type A and type B Programs	\$300,000
Auditee qualified as low-risk auditee?	No

**CITY OF PALACIOS, TEXAS**  
***SCHEDULE OF FINDINGS AND QUESTIONED COSTS***  
For the Year Ended September 30, 2014

**Section II - Financial Statement Findings**

No matters reported

**Section III - Federal Award Findings and Questioned Costs**

No matters reported

**Section IV - Status of Prior Year Findings and Questioned Costs**

No matters reported

**Section V - Corrective Action Plan**

No matters reported