

CITY OF PALACIOS, TEXAS
ANNUAL FINANCIAL REPORT
For the Year Ended September 30, 2017

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INTRODUCTORY SECTION

City of Palacios, Texas

DIRECTORY OF PRINCIPAL OFFICIALS

September 30, 2017

City Officials

Glen Smith
Johnny Tran
Judy Chavez
Mary Crocker
Troy S. Lewis
Andy Erdelt
Stephen McGovern

Elective Position

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

Key Staff

David Kocurek
Randall B. Strong
Linh Chau
Clissa Mills
David Miles
Tammy McDonald

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, 2017, 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, 2017, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

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

Other Information

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

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 7, 2018, on our consideration of the City of Palacios, Texas' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering City of Palacios, Texas' internal control over financial reporting and compliance.

Baker, Stogner, and Associates

El Campo, Texas

March 7, 2018

CITY OF PALACIOS, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
September 30, 2017

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, 2017.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$18,978,293 (*net position*). Of this amount, \$715,753 (*unrestricted net position*) may be used to meet the City's ongoing obligations to citizens and creditors.
- As of the close of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$1,150,094, an increase of \$28,589 from the prior year. At the end of the current fiscal year, unassigned fund balance for the General Fund was \$696,564, or 24% of total General Fund expenditures.
- The City's total debt of business-type activities decreased by \$397,580 or 9% during the fiscal year, ending with a balance of \$4,316,854 of which \$338,234 is due within one year.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Organization and Flow of Financial Section Information

Independent Auditors' Report

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

Management's Discussion and Analysis

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

Pages 9 to 15

Government-wide Financial Statements

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

Pages 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 54

OVERVIEW OF THE FINANCIAL STATEMENTS - (Continued)

Government-wide Financial Statements

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

Statement of Net Position

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

Statement of Activities

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

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

Fund Financial Statements

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

Governmental Funds

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

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

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

OVERVIEW OF THE FINANCIAL STATEMENTS - (Continued)

Governmental Funds - (Continued)

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

Proprietary Funds

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

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

Fiduciary Funds

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

Notes to Financial Statements

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

Other Information

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

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$18,978,293 at the close of the fiscal year 2017.

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS - (Continued)

City of Palacios, Texas						
Net Position						
	Governmental Activities		Business-type Activities		Total	
	2017	2016	2017	2016	2017	2016
Current and other assets	\$ 1,765,929	\$ 1,599,092	\$ 709,500	\$ 702,767	\$ 2,475,429	\$ 2,301,859
Capital assets (net)	4,462,271	3,168,993	18,427,697	18,803,097	22,889,968	21,972,090
Other noncurrent assets	-	-	-	-	-	-
Total assets	6,228,200	4,768,085	19,137,197	19,505,864	25,365,397	24,273,949
Deferred Outflow of Resource	380,405	300,665	118,276	98,062	-	-
Current liabilities	275,525	139,739	574,021	558,169	849,546	697,908
Noncurrent liabilities	1,917,389	1,204,877	3,998,727	4,373,608	5,916,116	5,578,485
Total liabilities	2,192,914	1,344,616	4,572,748	4,931,777	6,765,662	6,276,393
Deferred Inflow of Resources	90,222	84,228	29,901	28,382	-	-
Net Position						
Invested in capital assets, net of related debt	3,762,271	3,155,498	14,500,269	14,484,332	18,262,540	17,639,830
Unrestricted	563,198	484,408	152,555	159,435	715,753	643,843
Total net position	\$ 4,325,469	\$ 3,639,906	\$ 14,652,824	\$ 14,643,767	\$ 18,978,293	\$ 18,283,673

The balance of unrestricted net position, \$715,753, 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 \$685,563. Business-type activities increased the City's net position by \$9,057.

City of Palacios, Texas						
Changes in Net Position						
	Governmental		Business-type		Total	
	Activities		Activities			
	2,017	2,016	2,017	2,016	2,017	2,016
REVENUES						
Program revenues:						
Charges for services	\$ 163,149	\$ 128,881	\$ 1,648,055	\$ 1,731,225	\$ 1,811,204	\$ 1,860,106
Operating grants and contributions	164,397	51,089	-	-	164,397	51,089
Capital grants and contributions	302,930	119,662	325,930	52,200	628,860	171,862
General revenues:						
Property taxes	1,453,582	1,410,607	-	-	1,453,582	1,410,607
Sales taxes	477,648	491,064	-	-	477,648	491,064
Franchise taxes	147,156	146,546	-	-	147,156	146,546
Other taxes	39,668	39,751	-	-	39,668	39,751
Unrestricted investment earnings	6,187	3,170	1,246	978	7,433	4,148
Miscellaneous	924,090	1,465,375	46,521	51,671	970,611	1,517,046
Total revenues	<u>3,678,807</u>	<u>3,856,145</u>	<u>2,021,752</u>	<u>1,836,074</u>	<u>5,700,559</u>	<u>5,692,219</u>
EXPENSES						
General government	843,035	747,329	-	-	843,035	747,329
Public safety	1,264,030	1,309,077	-	-	1,264,030	1,309,077
Public works	898,127	547,616	-	-	898,127	547,616
Special services	151,046	145,694	-	-	151,046	145,694
Health and welfare	52,715	38,644	-	-	52,715	38,644
Interest on long-term debt	-	-	-	-	-	-
Water and sewer	-	-	1,695,446	1,871,889	1,695,446	1,871,889
Airport	-	-	101,540	100,132	101,540	100,132
Total expenses	<u>3,208,953</u>	<u>2,788,360</u>	<u>1,796,986</u>	<u>1,972,021</u>	<u>5,005,939</u>	<u>4,760,381</u>
Change in net position before transfers	469,854	1,067,785	224,766	(135,947)	694,620	931,838
Transfers	215,709	215,817	(215,709)	(215,817)	-	-
Change in net position	685,563	1,283,602	9,057	(351,764)	694,620	931,838
Net position - beginning	<u>3,639,906</u>	<u>2,356,304</u>	<u>14,643,767</u>	<u>14,995,531</u>	<u>18,283,673</u>	<u>17,351,835</u>
Net position - ending	<u>\$4,325,469</u>	<u>\$3,639,906</u>	<u>\$ 14,652,824</u>	<u>\$ 14,643,767</u>	<u>\$ 18,978,293</u>	<u>\$ 18,283,673</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 \$1,150,094, an increase of \$28,589 from the prior year.

Approximately 61% of this total amount, \$696,564 constitutes unassigned fund balance, which is available for spending at the City's discretion. The remainder of fund balance of \$453,530 or 39% 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 \$696,504. Unreserved fund balance represents 24% of total General Fund expenditures.

The fund balance of the City's General Fund decreased by \$234,640 during the current fiscal year. The decrease was primarily due to road repairs that had been budgeted.

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 \$139,813. Unrestricted net position of the Airport Fund amounted to \$12,742 at the end of the current fiscal year. This is a decrease of \$6,880 from the prior year for the proprietary funds.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

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

City of Palacios, Texas						
Capital Assets (Net of Depreciation)						
	Governmental Activities		Business-type Activities		Total	
	2,017	2,016	2,017	2,016	2,017	2,016
Land	\$ 357,286	\$ 357,286	\$ 8,129	\$ 8,129	\$ 365,415	\$ 365,415
Construction in progress	2,468,074	1,469,147	378,130	52,200	2,846,204	1,521,347
Buildings and improvements	566,926	587,401	103,260	144,145	670,186	731,546
Machinery and equipment	238,508	214,857	286,076	343,730	524,584	558,587
Land structured facilities	831,477	540,302	1,208,282	1,258,769	2,039,759	1,799,071
Water and sewer system	-	-	16,473,646	17,015,353	16,473,646	17,015,353
Total	<u>\$ 4,462,271</u>	<u>\$ 3,168,993</u>	<u>\$ 18,457,523</u>	<u>\$ 18,822,326</u>	<u>\$ 22,919,794</u>	<u>\$ 21,991,319</u>

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

CAPITAL ASSETS AND DEBT ADMINISTRATION - (Continued)

Long-Term Debt

During the 2011 fiscal year, the City issued \$3,580,000 in Certificate of Obligation Bonds in order to fund water and sewer improvements. The amount outstanding at year end is \$2,845,000. The 2011 bonds mature in 2031. In the 2010 fiscal year, the City was deeded certain water and sewer improvements that were constructed by a developer. The City has agreed to reimburse the developer certain costs that were incurred in the construction of the improvements. The net amount owed to the developer at year end was \$803,637. 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. The city issued \$700,000 Tax Notes series 2017 to provide funds for the completion of the Pavilion Restoration.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The following factors were considered in preparing the City's budget for the 2017-2018 fiscal year.

The total sales tax payments received by the City from the State Comptroller in fiscal year 2017 totaled \$477,647. This amount is a decrease of \$13,417 under the previous year.

The certified assessed taxable property valuations for the 2017 tax roll total \$188,230,001 with a tax rate of \$0.85351 per \$100 valuation. \$0.84 was allocated for maintenance and operations. The projected total property tax due is \$92,045 higher than the current year. The certified assessed taxable property valuations were more than the 2016 values.

Of the of projected 2017 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, \$601,433 had been reimbursed leaving a balance of \$803,657.

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, 2017

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
ASSETS				
Current assets				
Cash and cash equivalents	\$ 1,203,672	\$ 362,727	\$ 1,566,399	\$ 441,884
Receivables (net)	415,892	329,552	745,444	2,591
Internal balances	53,394	(53,394)	-	-
Due from other governments	86,679	-	86,679	27,418
Inventory	6,292	70,615	76,907	-
Total current assets	<u>1,765,929</u>	<u>709,500</u>	<u>2,475,429</u>	<u>471,893</u>
Noncurrent assets				
Capital assets				
Land and other assets not being depreciated	2,825,360	386,259	3,211,619	-
Buildings, improvements, and equipment (net)	1,636,911	18,025,121	19,662,032	-
Deferred expenses (net)	-	16,317	16,317	-
Total noncurrent assets	<u>4,462,271</u>	<u>18,427,697</u>	<u>22,889,968</u>	<u>-</u>
Total assets	<u>6,228,200</u>	<u>19,137,197</u>	<u>25,365,397</u>	<u>471,893</u>
DEFERRED OUTFLOWS OF RESOURCES				
Deferred Outflows of Resources (net)	380,405	118,276	498,681	12,649
Total Deferred Outflow of Resources	<u>380,405</u>	<u>118,276</u>	<u>498,681</u>	<u>12,649</u>

CITY OF PALACIOS, TEXAS

STATEMENT OF NET POSITION (continued)

September 30, 2017

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Palacios Economic Development Corporation
LIABILITIES				
Current liabilities				
Accounts payable	\$ 95,883	\$ 75,711	\$ 171,594	\$ 3,327
Accrued expenses	45,714	9,742	55,456	1,331
Accrued interest payable	-	14,069	14,069	-
Due to other governments	26,585	-	26,585	-
Customer meter deposits	-	130,628	130,628	-
Accrued compensated absences	18,343	5,637	23,980	152
Payable to developer	-	50,000	50,000	-
Current portion of long-term obligations	89,000	288,234	377,234	-
Total current liabilities	<u>275,525</u>	<u>574,021</u>	<u>849,546</u>	<u>4,810</u>
Noncurrent liabilities				
Net Pension Liability	1,306,389	423,602	1,729,991	13,632
Noncurrent portion of long-term obligations	611,000	3,575,125	4,186,125	-
Total noncurrent liabilities	<u>1,917,389</u>	<u>3,998,727</u>	<u>5,916,116</u>	<u>13,632</u>
Total liabilities	<u>2,192,914</u>	<u>4,572,748</u>	<u>6,765,662</u>	<u>18,442</u>
DEFERRED INFLOWS OF RESOURCES				
Deferred Inflows of Resources (net)	90,222	29,901	120,123	33,223
Total Deferred Inflows of Resources	<u>90,222</u>	<u>29,901</u>	<u>120,123</u>	<u>33,223</u>
NET POSITION				
Invested in capital assets, net of related debt	3,762,271	14,500,269	18,262,540	-
Unrestricted	563,198	152,555	715,753	432,877
Total net position	<u>\$ 4,325,469</u>	<u>\$ 14,652,824</u>	<u>\$ 18,978,293</u>	<u>\$ 432,877</u>

CITY OF PALACIOS, TEXAS

STATEMENT OF ACTIVITIES

For the year ended September 30, 2017

Function/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government				
Governmental activities				
General government	\$ 843,035	\$ 32,322	\$ -	\$ -
Public safety	1,264,030	130,827	-	-
Public works	898,127	-	164,397	302,930
Special services	151,046	-	-	-
Health and welfare	52,715	-	-	-
Interest on long-term debt	-	-	-	-
Total governmental activities	<u>3,208,953</u>	<u>163,149</u>	<u>164,397</u>	<u>302,930</u>
Business-type activities				
Water and sewer	1,695,446	1,624,369	-	-
Airport	<u>101,540</u>	<u>23,686</u>	-	-
Total business-type activities	<u>1,796,986</u>	<u>1,648,055</u>	-	-
Total primary government	<u>\$ 5,005,939</u>	<u>\$ 1,811,204</u>	<u>\$ 164,397</u>	<u>\$ 302,930</u>
Component Unit				
Palacios Economic Development Corporation	<u>\$ 151,589</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

General revenues:

Taxes:

Property taxes, levied for general purposes

Property taxes, levied for debt service

Sales taxes

Franchise taxes

Other taxes and fees

Unrestricted investment earnings

Miscellaneous

Transfers

Capital contributions

Total general revenues and transfers

Change in net position

Net position - beginning

Net position - ending

The accompanying notes are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Position			Component Unit
Primary Government			Palacios Economic Development Corporation
Governmental Activities	Business- type Activities	Total	
(810,713)	\$ -	\$ (810,713)	\$ -
(1,133,203)	-	(1,133,203)	-
(430,800)	-	(430,800)	-
(151,046)	-	(151,046)	-
(52,715)	-	(52,715)	-
-	-	-	-
<u>(2,578,477)</u>	<u>-</u>	<u>(2,578,477)</u>	<u>-</u>
-	(71,077)	(71,077)	-
-	(77,854)	(77,854)	-
-	(148,931)	(148,931)	-
<u>(2,578,477)</u>	<u>(148,931)</u>	<u>(2,727,408)</u>	<u>-</u>
-	-	-	(151,589)
1,452,446	-	1,452,446	-
1,136	-	1,136	-
477,648	-	477,648	159,216
147,156	-	147,156	-
39,668	-	39,668	-
6,187	1,246	7,433	1,481
924,090	46,521	970,611	20,379
215,709	(215,709)	-	-
-	325,930	325,930	-
<u>3,264,040</u>	<u>157,988</u>	<u>3,422,028</u>	<u>181,076</u>
685,563	9,057	694,620	29,487
<u>3,639,906</u>	<u>14,643,767</u>	<u>18,283,673</u>	<u>403,390</u>
<u>\$ 4,325,469</u>	<u>\$ 14,652,824</u>	<u>\$ 18,978,293</u>	<u>\$ 432,877</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS*BALANCE SHEET**GOVERNMENTAL FUNDS**September 30, 2017*

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS			
Current assets			
Cash and cash equivalents	\$ 614,042	\$ 515,312	\$ 1,129,354
Receivables (net)	401,662	14,230	415,892
Due from other governments	86,660	19	86,679
Due from other funds	87,389	238	87,627
Inventory	<u>6,292</u>	<u>-</u>	<u>6,292</u>
Total assets	<u>1,196,045</u>	<u>529,799</u>	<u>1,725,844</u>
LIABILITIES AND FUND BALANCES			
Liabilities			
Accounts payable	35,122	42,991	78,113
Accrued expenditures	45,714	-	45,714
Due to other funds	238	33,995	34,233
Due to other governments	<u>21,783</u>	<u>4,802</u>	<u>26,585</u>
Total liabilities	<u>102,857</u>	<u>81,788</u>	<u>184,645</u>
Deferred Inflows of Resources			
Unearned Revenue	<u>390,332</u>	<u>773</u>	<u>391,105</u>
Total Deferred Inflow of Resources	<u>390,332</u>	<u>773</u>	<u>391,105</u>
Fund balances			
Nonspendable	6,292	-	6,292
Restricted	-	447,238	447,238
Unassigned	<u>696,564</u>	<u>-</u>	<u>696,564</u>
Total fund balances	<u>702,856</u>	<u>447,238</u>	<u>1,150,094</u>
Total liabilities and fund balances	<u>\$ 1,196,045</u>	<u>\$ 529,799</u>	<u>\$ 1,725,844</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, 2017

Total governmental fund balances		\$ 1,150,094
<i>Amounts reported for governmental activities in the statement of net position are different because:</i>		
The Internal Service Fund is used by the City to account for the costs of equipment owned by the City. The assets and liabilities of the Internal Service Fund are included in governmental activities in the statement of net position.		
		135,281
Property taxes, fines and weedy lot receivables will be collected this year, but are not available soon enough to pay for the current period's expenditures, unearned revenue and therefore are deferred in the funds.		
		391,105
Capital assets used in governmental activities are reported as expenditures in governmental funds when purchased or constructed. The cost of these assets is \$8,381,309 and the accumulated depreciation is \$5,330,276.		
		4,383,538
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	\$ (700,000)	
Net Pension Liability	(1,306,389)	
Compensated absences	<u>(18,343)</u>	(2,024,732)
The net deferred outflows and inflows making up Net Pension Liability are not recorded in the funds		
		<u>290,183</u>
Net position of governmental activities		<u>\$ 4,325,469</u>

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

For the year ended September 30, 2017

	General	Other Governmental Funds	Total Governmental Funds
REVENUES			
Taxes	\$ 2,101,417	\$ 35,270	\$ 2,136,687
Licenses and permits	32,322	-	32,322
Intergovernmental	164,397	302,930	467,327
Charges for services	-	-	-
Fines and forfeitures	123,355	7,472	130,827
Investment income	4,663	1,441	6,104
Miscellaneous	<u>318,362</u>	<u>569,779</u>	<u>888,141</u>
Total revenues	<u>2,744,516</u>	<u>916,892</u>	<u>3,661,408</u>
EXPENDITURES			
Current			
General government	718,000	41,699	759,699
Public safety	1,241,071	-	1,241,071
Public works	796,248	1,356,464	2,152,712
Special services	138,920	-	138,920
Health and welfare	49,126	-	49,126
Debt service			
Principal retirement	-	-	-
Interest and fiscal charges	-	-	-
Total expenditures	<u>2,943,365</u>	<u>1,398,163</u>	<u>4,341,528</u>
Excess (deficiency) of revenues over expenditures	(198,849)	(481,271)	(680,120)
OTHER FINANCING SOURCES (USES)			
Proceeds from Debt		700,000	700,000
Transfers in	158,600	52,500	211,100
Transfers out	<u>(194,391)</u>	<u>(8,000)</u>	<u>(202,391)</u>
Total other financing sources (uses)	<u>(35,791)</u>	<u>744,500</u>	<u>708,709</u>
Net change in fund balances	(234,640)	263,229	28,589
Fund balances (as restated), at beginning of year	<u>937,496</u>	<u>184,009</u>	<u>1,121,505</u>
Fund balances at end of year	<u>\$ 702,856</u>	<u>\$ 447,238</u>	<u>\$ 1,150,094</u>

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, 2017*

Total net change in fund balances - governmental funds	\$ 28,589
<i>Amounts reported for governmental activities in the statement of activities are different because:</i>	
The Internal Service Fund is used by the City to account for the costs of equipment owned by the City. The net income of the Internal Service Fund is reported with governmental activities.	19,444
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 2015-2016 capital outlays is to increase net position.	1,453,212
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.	(120,708)
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: Tax Notes issued	(700,000)
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.	17,316
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: Increase in pension liability Decrease in compensated absences	(27,766) 15,476
	<u>15,476</u>
Change in net position of governmental activities	<u>\$ 685,563</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS
STATEMENT OF NET POSITION
PROPRIETARY FUNDS
September 30, 2017

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
ASSETS				
Current assets				
Cash and cash equivalents	\$ 362,727	\$ -	\$ 362,727	\$ 74,318
Receivables (net)	329,352	200	329,552	-
Due from other funds	-	-	-	-
Inventory	50,231	20,384	70,615	-
Total current assets	742,310	20,584	762,894	74,318
Noncurrent assets				
Land and other assets not being depreciated	386,259	-	386,259	-
Buildings, improvements, and equipment (net)	16,861,852	1,163,269	18,025,121	78,733
Prepaid Interest	16,317	-	16,317	-
Total noncurrent assets	17,264,428	1,163,269	18,427,697	78,733
Total assets	18,006,738	1,183,853	19,190,591	153,051
DEFERRED OUTFLOWS OF RESOURCES				
Contributions after 12/31/16 through 9/30/17	118,276	-	118,276	-
Total Deferred Outflows of Resources	118,276	-	118,276	-
LIABILITIES				
Current liabilities				
Accounts payable	74,540	1,171	75,711	17,770
Accrued expenses	9,742	-	9,742	-
Due to other funds	46,723	6,671	53,394	-
Accrued interest payable	14,069	-	14,069	-
Customer meter deposits	130,628	-	130,628	-
Accrued compensated absences	5,637	-	5,637	-
Current portion of notes	88,234	-	88,234	-
Current portion of payable to developer	50,000	-	50,000	-
Current portion of general obligation bonds	200,000	-	200,000	-
Total current liabilities	619,573	7,842	627,415	17,770
Noncurrent liabilities				
Net Pension Liability	423,602	-	423,602	-
Notes payable	176,468	-	176,468	-
General obligation bonds	-	-	-	-
Certificates of obligation	2,645,000	-	2,645,000	-
Payable to developer	753,657	-	753,657	-
Total noncurrent liabilities	3,998,727	-	3,998,727	-
Total liabilities	4,618,300	7,842	4,626,142	17,770
DEFERRED INFLOWS OF RESOURCES				
Actual expense vs assumptions	29,901	-	29,901	-
Total Deferred Inflows of Resources	29,901	-	29,901	-
NET POSITION				
Invested in capital assets, net of related debt	13,337,000	1,163,269	14,500,269	78,733
Unrestricted net position	139,813	12,742	152,555	56,548
Total net position	\$ 13,476,813	\$ 1,176,011	\$ 14,652,824	\$ 135,281

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, 2017

	Business-type Activities			Governmental Activities- Internal Service Fund
	Water and Sewer	Airport	Total	
OPERATING REVENUES				
Charges for services	\$ 1,624,369	\$ 9,915	\$ 1,634,284	\$ -
Rents	-	13,771	13,771	-
Total operating revenues	<u>1,624,369</u>	<u>23,686</u>	<u>1,648,055</u>	<u>-</u>
OPERATING EXPENSES				
Water system	569,665	-	569,665	-
Sanitary sewer system	288,156	-	288,156	-
Solid waste	-	-	-	-
Airport expenses	-	55,401	55,401	-
Miscellaneous	23,818	-	23,818	-
Equipment expenses	-	-	-	135,130
Depreciation and amortization	685,674	46,139	731,813	52,509
Total operating expenses	<u>1,567,313</u>	<u>101,540</u>	<u>1,668,853</u>	<u>187,639</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	57,056	(77,854)	(20,798)	(187,639)
NONOPERATING REVENUES (EXPENSES)				
Investment income	1,227	19	1,246	83
Connection fees	7,510	-	7,510	-
Miscellaneous income	1,945	13,329	15,274	-
Nonoperating lease income	-	23,737	23,737	-
Interest and fiscal charges	(128,133)	-	(128,133)	-
Total nonoperating revenues (expenses)	<u>(117,451)</u>	<u>37,085</u>	<u>(80,366)</u>	<u>83</u>
Income (loss) before contributions and transfers	(60,395)	(40,769)	(101,164)	(187,556)
Contributions and transfers				
Capital contributions	325,930	-	325,930	-
Transfers in	112,391	-	112,391	207,000
Transfers out	(328,100)	-	(328,100)	-
Total contributions and transfers	<u>110,221</u>	<u>-</u>	<u>110,221</u>	<u>207,000</u>
Change in net position	49,826	(40,769)	9,057	19,444
Total net position at beginning of year	<u>13,426,987</u>	<u>1,216,780</u>	<u>14,643,767</u>	<u>115,837</u>
Total net position at end of year	<u>\$ 13,476,813</u>	<u>\$ 1,176,011</u>	<u>\$ 14,652,824</u>	<u>\$ 135,281</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, 2017*

	<u>Business-type Activities</u>			Governmental Activities- Internal Service Fund
	<u>Water and Sewer</u>	<u>Airport</u>	<u>Total</u>	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers	\$ 1,606,968	\$ 23,786	\$ 1,630,754	\$ -
Cash paid to suppliers for goods and services	(558,673)	(66,347)	(625,020)	(123,317)
Cash paid to employees for services	(318,019)	-	(318,019)	-
Net cash provided (used) by operating activities	<u>730,276</u>	<u>(42,561)</u>	<u>687,715</u>	<u>(123,317)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Transfers (to) from other funds	(215,709)	-	(215,709)	207,000
Borrowings (repayments) to other funds	-	5,475	5,475	-
Connection fees	7,510	-	7,510	-
Miscellaneous income (expense)	1,945	37,067	39,012	-
Increase (decrease) in customer meter deposits	10,940	-	10,940	-
Net cash provided (used) by noncapital financing activities	<u>(195,314)</u>	<u>42,542</u>	<u>(152,772)</u>	<u>207,000</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition and construction of capital assets	(41,079)	-	(41,079)	(13,283)
Change in prepaid interest	10,595	-	10,595	-
Proceeds from issuance of debt	-	-	-	-
Principal paid on long-term debt	(390,625)	-	(390,625)	(13,495)
Interest paid	(128,845)	-	(128,845)	-
Net cash provided (used) by capital and related financing activities	<u>(549,954)</u>	<u>-</u>	<u>(549,954)</u>	<u>(26,778)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment income	1,227	19	1,246	83
Net cash provided (used) by investing activities	<u>1,227</u>	<u>19</u>	<u>1,246</u>	<u>83</u>
Net increase (decrease) in cash and cash equivalents	(13,765)	-	(13,765)	56,988
Cash and cash equivalents at beginning of year	376,492	-	376,492	17,330
Cash and cash equivalents at end of year	<u>\$ 362,727</u>	<u>\$ -</u>	<u>\$ 362,727</u>	<u>\$ 74,318</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, 2017*

	<u>Business-type Activities</u>			<u>Governmental Activities- Internal Service Fund</u>
	<u>Water and Sewer</u>	<u>Airport</u>	<u>Total</u>	
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES				
Operating income (loss)	\$ 57,056	\$ (77,854)	\$ (20,798)	\$ (187,639)
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation and amortization	685,674	46,139	731,813	52,509
Changes in assets and liabilities				
(Increase) decrease in accounts receivable	(17,401)	100	(17,301)	-
(Increase) decrease in inventory	2,592	(11,264)	(8,672)	-
Increase (decrease) in accounts payable	232	318	550	11,813
Increase (decrease) in accrued expenses	2,028	-	2,028	-
Increase (decrease) in accrued pension	7,049	-	7,049	-
Increase (decrease) in compensated absences	(6,954)	-	(6,954)	-
Total adjustments	<u>673,220</u>	<u>35,293</u>	<u>708,513</u>	<u>64,322</u>
Net cash provided (used) by operating activities	<u>\$ 730,276</u>	<u>\$ (42,561)</u>	<u>\$ 687,715</u>	<u>\$ (123,317)</u>
Noncash capital and related financing activities				
Infrastructure improvements contributed by other Governments	<u>\$ 325,930</u>			

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

STATEMENT OF FIDUCIARY NET POSITION

FIDUCIARY FUNDS

September 30, 2016

	<u>Agency Fund</u>
ASSETS	
Cash and cash equivalents	\$ <u>54,322</u>
Total assets	\$ <u><u>54,322</u></u>
LIABILITIES	
Liabilities	
Due to others	\$ <u>54,322</u>
Total liabilities	\$ <u><u>54,322</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.

B. Component Unit

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

The Palacios Economic Development Corporation (the "Corporation") was created for the purpose of benefiting and accomplishing public purposes of the City by promoting, encouraging, and enhancing the creation of jobs in the City. This is to be achieved through assistance in the retention of existing businesses and industries and the attraction of new businesses and industries and aid in their development and growth. Each Director of the Corporation is appointed to office by the City Council. Once appointed, they may be removed from office at will by a majority vote of the Council members. Under guidelines established by GASB, this fact makes the Corporation financially accountable to the City. Because other necessary conditions are also met, the Corporation has been included as a discretely presented component unit of the City in the accompanying financial statements. The Corporation uses the same fiscal year as the City and is presented as a governmental fund type. No other organizations met the necessary criteria to be considered component units of the City for the year ending September 30, 2017.

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

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

C. Government-wide and Fund Financial Statements

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

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

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

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

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

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

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

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

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

The City reports the following major governmental fund:

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

The City reports the following major proprietary funds:

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

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

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

Additionally, the City reports the following fund types:

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

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

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

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

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

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

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

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

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

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

E. Budgets and Budgetary Accounting

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

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

F. Deposits and Investments

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

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

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

F. Deposits and Investments – (Continued)

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

As of September 30, 2017, the City has adopted a formal investment policy.

G. Receivables and Payables

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

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

H. Inventory and Prepaid Items

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

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

I. Capital Assets

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

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

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

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

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

I. Capital Assets – (Continued)

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

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

J. Compensated Absences

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

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

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

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

K. Long-Term Obligations

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

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

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

L. Deferred Outflows/Inflows of Resources

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

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

M. Pensions

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

N. Fund Equity

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

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

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

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

O. Use of Estimates

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

NOTE 2: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Budgetary Compliance

There were three departments that expenditures exceeded the amount appropriated during the fiscal year 2016-2017.

<u>General Fund - Department</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Negative Variance</u>
Mayor and City Council	\$ 28,550	\$ 28,595	\$ (45)
Parks Maintenance	331,000	345,962	(14,962)
Streets	446,250	450,286	(4,036)

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 9/30/17 were \$1,945,000 in collateral value and \$1,968,721 in market value.

As of September 30, 2017, 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	\$ 1,318,603	44

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

Interest Rate Risk

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

NOTE 3: DEPOSITS AND INVESTMENTS (Continued)

Credit Risk

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

Concentration of Credit Risk

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

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City's investment policy requires that deposits at financial institutions be insured by the FDIC and/or collateralized by securities pledged to the City by the depository in an amount equal to at least 110% of the carrying value of deposits held. During the fiscal year and at year-end, all deposits held in the depository bank were fully collateralized and therefore the City was not exposed to custodial credit risk. Pledged securities at Compass Bank for the year ended 9/30/17 were \$1,945,000 in collateral value and \$1,968,721 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, 2017, 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	\$ 48,548	\$ 494,648	\$ 200	\$ -	\$ 543,396
Ad valorem taxes	473,385	-	-	773	474,158
Franchise taxes	15,206	-	-	-	15,206
Fines	88,549	-	-	-	88,549
Other	-	429	-	13,457	13,886
Total gross receivables	625,688	495,077	200	14,230	1,135,195
Less: allowances	<u>224,026</u>	<u>165,725</u>	-	-	<u>389,751</u>
Total net receivables	<u>\$ 401,662</u>	<u>\$ 329,352</u>	<u>\$ 200</u>	<u>\$ 14,230</u>	<u>\$ 745,444</u>

NOTE 4: RECEIVABLES (Continued)

The City's governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. The governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue and unearned revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>	<u>Total</u>
General Fund			
Ad valorem taxes	\$ 297,565	\$ -	\$ 297,565
Fines	88,549	-	88,549
Weedy lot mowing	4,218	-	4,218
Debt Service Fund			
Ad valorem taxes	<u>773</u>	<u>-</u>	<u>773</u>
	<u>\$ 391,105</u>	<u>\$ -</u>	<u>\$ 391,105</u>

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

For the current year, the City levied property taxes of \$0.8400 per \$100 of assessed valuation. The entire amount was allocated for maintenance and operations. The resulting adjusted total tax levy was \$1,452,699 on the total adjusted taxable valuation of \$180,371,062 for the 2016 tax roll.

NOTE 5: CAPITAL ASSETS

The City's capital assets activity for the year ended September 30, 2017, was as follows:

	9/30/2016 Beginning Balance	Increases	Decreases	9/30/2017 Ending Balance
Governmental activities				
Capital assets, not being depreciated				
Land	\$ 357,286	\$ -	\$ -	\$ 357,286
Construction in progress	<u>1,469,147</u>	<u>998,927</u>	<u>-</u>	<u>2,468,074</u>
Total capital assets not being depreciated	<u>1,826,433</u>	<u>998,927</u>	<u>-</u>	<u>2,825,360</u>
Capital assets, being depreciated				
Machinery and equipment	2,260,855	116,781	-	2,377,636
Land structured facilities	4,718,044	350,787	-	5,068,831
Buildings	<u>947,265</u>	<u>-</u>	<u>-</u>	<u>947,265</u>
Total capital assets being depreciated	<u>7,926,163</u>	<u>467,568</u>	<u>-</u>	<u>8,393,731</u>
Less accumulated depreciation for				
Machinery and equipment	2,045,998	93,130	-	2,139,128
Land structured facilities	4,177,741	59,613	-	4,237,354
Buildings	<u>359,864</u>	<u>20,474</u>	<u>-</u>	<u>380,338</u>
Total accumulated depreciation	<u>6,583,603</u>	<u>173,217</u>	<u>-</u>	<u>6,756,820</u>
Total capital assets being depreciated, net	<u>1,342,560</u>	<u>294,351</u>	<u>-</u>	<u>1,636,911</u>
Governmental activities capital assets, net	<u>\$ 3,168,993</u>	<u>\$ 1,293,278</u>	<u>\$ -</u>	<u>\$ 4,462,271</u>
Business-type activities				
Capital assets, not being depreciated				
Land	\$ 8,129	\$ -	\$ -	\$ 8,129
Construction in progress	<u>52,200</u>	<u>325,930</u>	<u>-</u>	<u>378,130</u>
Total capital assets not being depreciated	<u>60,329</u>	<u>325,930</u>	<u>-</u>	<u>386,259</u>
Capital assets, being depreciated				
Machinery and equipment	1,081,079	-	-	1,081,079
Buildings and improvements	3,475,561	41,079	-	3,516,640
Water and sewer system	22,957,564	-	-	22,957,564
Land structured facilities	<u>2,341,521</u>	<u>-</u>	<u>-</u>	<u>2,341,521</u>
Total capital assets being depreciated	<u>29,855,724</u>	<u>41,079</u>	<u>-</u>	<u>29,896,803</u>
Less accumulated depreciation for				
Machinery and equipment	737,346	57,657	-	795,003
Buildings and improvements	3,331,416	81,964	-	3,413,380
Water works system	5,942,211	541,705	-	6,483,916
Land structured facilities	<u>1,128,895</u>	<u>50,487</u>	<u>-</u>	<u>1,179,382</u>
Total accumulated depreciation	<u>11,139,869</u>	<u>731,813</u>	<u>-</u>	<u>11,871,683</u>
Total capital assets being depreciated, net	<u>18,715,855</u>	<u>(364,804)</u>	<u>-</u>	<u>18,025,121</u>
Business-type activities capital assets, net	<u>\$ 18,776,184</u>	<u>\$ (364,804)</u>	<u>\$ -</u>	<u>\$ 18,411,382</u>

NOTE 5: CAPITAL ASSETS – (Continued)

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

Governmental activities

General government	\$ 67,553
Public safety	45,063
Public works	48,500
Public health	<u>12,101</u>
Total depreciation expense - governmental activities	<u>\$ 173,217</u>

Business-type activities

Utilities	\$ 685,664
Airport	<u>46,149</u>
Total depreciation expense - business-type activities	<u>\$ 731,813</u>

The Palacios Economic Development Corporation has \$12,799 of capital assets at September 30, 2017, consisting of various equipment and leasehold improvements. These assets were fully depreciated at September 30, 2017.

NOTE 6: EMPLOYEES' RETIREMENT PLAN

Plan Description

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

Benefits Provided

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

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

NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)

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

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

Inactive employees or beneficiaries currently receiving benefits	19
Inactive employees entitled to but not yet receiving benefits	39
Active employees	<u>35</u>
	93

Contributions

The contribution rates for employees in TMRS are either 5%, 6%, or 7% of employees gross earnings, and the City matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of the City. Under the state law governing TMRS, the contribution rate for each City is determined annually by the actuary, using the Entry Age Normal (EAN) actuarial cost method. The actuarially determined rate is the estimated amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Employees for the City were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution plan rates for the City were 16.44% and 17.39% in calendar years 2015 and 2016, respectively. The City's contributions to TMRS for the fiscal year ended September 30, 2017 were \$246,682, and were equal to the required contributions.

Net Pension Liability

The City's Net Pension Liability (NPL) was measured as of December 31, 2016, and the Total Pension Liability (TPL) used to calculate the Net Pension Liability was determined by an actuarial valuation as of that date.

Actuarial Assumptions

The Total Pension Liability in the December 31, 2016 actuarial valuation was determined using the following actuarial assumptions:

NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)

Valuation Date	December 31st
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percentage of Payroll, Closed
Remaining Amortization Period	30 Years
Asset Valuation Method	10 year Smoothed Market; 15% Soft Corridor
Inflation	2.50%
Overall Payroll Growth	3.00%
Salary Increases	3.50 % to 10.50% including inflation
Investment Rate of Return*	6.75%
Retirement Age	Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2016 valuation pursuant to an experience study of the period 2010-2015.
Mortality	RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB.

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

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

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

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

NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)

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

Discount Rate

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

	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
	(a)	(b)	(a) - (b)
Balance at 12/31/2015	\$ 5,552,449	\$ 3,849,276	\$ 1,703,173
Changes for the year:			-
Service cost	246,872	-	246,872
Interest	375,955	-	375,955
Changes of benefit terms	-	-	-
Difference between expected and actual experience	(12,388)	-	(12,388)
Change of assumptions	-	-	-
Contributions - Employer	-	231,331	(231,331)
Contributions - Employee	-	96,273	(96,273)
Net Investment Income	-	259,913	(259,913)
Benefit payments, including refunds of employee contributions	(212,348)	(212,348)	-
Administrative expense	-	(2,938)	2,938
Other changes	-	(157)	157
Net changes	<u>398,091</u>	<u>372,074</u>	<u>26,017</u>
Balance at 12/31/2016	<u>\$ 5,950,540</u>	<u>\$ 4,221,350</u>	<u>\$ 1,729,191</u>

NOTE 6: EMPLOYEES' RETIREMENT PLAN (Continued)

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

The following presents the Net Pension Liability of the City, calculated using the discount rate of 7.0%, as well as what the City's Net Pension Liability would be if it were calculated using a discount rate that is 1-percentage point lower (5.75%) or 1-percentage point higher (7.75%) than the current rate.

	1.0% Decrease in Discount Rate 5.75%	Current Single Rate Assumption 6.75%	1.0% Increase in Discount Rate (7.75%)
City's Net Pension Liability:	\$ 2,578,517	\$ 1,729,191	\$ 1,037,135

Pension Plan Fiduciary Net Position

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

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

For the year ended September 30, 2017 the City recognized pension expense of \$246,682.

At September 30, 2017, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ (12,388)
Changes in actuarial assumptions	-	-
Difference between projected and actual investment earnings	(87)	-
Contributions subsequent to the measurement date	-	-
Total	\$ (87)	\$ (12,388)

\$234,494 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending September 30, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	Pension Expense Amount
2017	\$ 46,391
2018	56,681
2019	50,857
2020	(19)
2021	-
Thereafter	-
Total	\$ 153,910

NOTE 7: SUPPLEMENTAL DEATH BENEFIT PLAN

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

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

NOTE 8: RISK MANAGEMENT

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

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

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

NOTE 9: LONG-TERM DEBT

A. Changes in Long-Term Liabilities

Long-term liability activity for the year ended September 30, 2017, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Governmental activities					
Tax notes	\$ -	\$ 700,000	\$ -	\$ 700,000	\$ 89,000
Compensated absences	33,819	-	15,476	18,343	-
Net Pension Liability	1,204,877	101,512	-	\$ 1,306,389	-
Equipment notes	<u>13,494</u>	<u>-</u>	<u>13,494</u>	<u>-</u>	<u>-</u>
Total governmental activity long-term liabilities	<u>\$ 1,252,190</u>	<u>\$ 801,512</u>	<u>\$ 28,970</u>	<u>\$ 2,024,732</u>	<u>\$ 89,000</u>
Business-type activities					
General obligation bonds	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of obligation	3,035,000	-	190,000	2,845,000	200,000
Note Payable - Gov Cap Corp	352,936	-	88,234	264,702	88,234
Compensated absences	12,592	-	6,955	5,637	-
Net Pension Liability	397,858	25,744	-	423,602	-
Payable to developer	<u>916,048</u>	<u>-</u>	<u>112,391</u>	<u>803,657</u>	<u>50,000</u>
Total business-type activity long-term liabilities	<u>\$ 4,714,434</u>	<u>\$ 25,744</u>	<u>\$ 397,580</u>	<u>\$ 4,342,598</u>	<u>\$ 338,234</u>

NOTE 9: LONG-TERM DEBT – (Continued)

B. General Obligation Refunding Bonds and Certificates of Obligation

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

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

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

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

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

<u>Year</u>	<u>Business-type Activities</u>		<u>Total</u>
	<u>Pricipal</u>	<u>Interest</u>	
2017	\$ 200,000	\$ 112,550	\$ 312,550
2019-2021	635,000	297,425	932,425
2022-2026	905,000	344,100	1,249,100
<u>2027-2031</u>	<u>1,105,000</u>	<u>145,500</u>	<u>1,250,500</u>
	-	-	-
	<u>\$ 2,845,000</u>	<u>\$ 899,575</u>	<u>\$ 3,744,575</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.

NOTE 9: LONG-TERM DEBT – (Continued)

Year	Business-type Activities		Total
	Principal	Interest	
2/15/2018	\$ 89,000	\$ 13,461	\$ 102,461
8/15/2018		6,568	6,568
2/15/2019	96,000	6,568	102,568
8/15/2019		5,536	5,536
2/15/2020	99,000	5,536	104,536
8/15/2020		4,472	4,472
2/15/2021	101,000	4,472	105,472
8/15/2021		3,386	3,386
2/15/2022	103,000	3,386	106,386
8/15/2022		2,279	2,279
2/15/2023	105,000	2,279	107,279
8/15/2023		1,150	1,150
2/15/2024	107,000	1,150	108,150
	-	-	-
	<u>\$ 700,000</u>	<u>\$ 60,245</u>	<u>\$ 760,245</u>

D. Equipment Notes

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

Year	Business -type Activities		Total
	Principal	Interest	
2018	-	-	-
Totals	<u>-</u>	<u>-</u>	<u>-</u>

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

Year	Business -type Activities		Total
	Principal	Interest	
2018	80,161	8,073	88,234
2019	82,767	5,467	88,234
2020	85,457	2,777	88,234
	<u>248,385</u>	<u>16,317</u>	<u>264,702</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

NOTE 9: LONG-TERM DEBT – (Continued)

developer amounted to \$1,405,101. The City has agreed to pay the developer 75% of the property taxes collected based on a formula agreed upon by the parties. The City will continue to pay the developer on an annual basis until 100% of the \$1,405,101 has been repaid. The City has made payments of \$66,982, \$87,154, \$50,017, \$32,785, \$24,807, \$91,889, \$76,356, \$59,783 and \$112,391 for the 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017 fiscal years, respectively. The City has recorded the net liability of \$803,657 in the accompanying financial statements. There is no predetermined repayment schedule since the amounts paid annually depend on the amount of taxes collected on certain properties. The accompanying financial statements reflect an estimated current portion of \$50,000.

NOTE 10: INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS

A. Interfund Receivables and Payables

At times during the fiscal year the various funds of the City were involved in transactions that created interfund receivable and payable balances. These transactions related to such things as the purchase of goods by one fund on behalf of another and the receipt of revenue in one fund that belongs to or is designated for another fund. Interfund receivable and payable balances as of September 30 2017, were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Airport	\$ 6,671
	Water and Sewer	46,723
	HOME	1,275
	Disaster	32,720
Debt Service	General	<u>238</u>
		<u>\$ 87,627</u>

B. Interfund Transfers

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

<u>Transfers Out</u>	<u>Transfers In</u>				<u>Total</u>
	<u>General Fund</u>	<u>Equipment Fund</u>	<u>Water & Sewer</u>	<u>TCDP Sewer Project</u>	
General	\$ -	\$ 82,000	\$ 112,391	\$ -	\$ 194,391
Nonmajor Governmental	8,000	-	-	-	8,000
Water and Sewer	150,600	125,000	-	52,500	328,100
Airport	-	-	-	-	-
	<u>\$ 158,600</u>	<u>\$ 207,000</u>	<u>\$ 112,391</u>	<u>\$ 52,500</u>	<u>\$ 530,491</u>

NOTE 11: COMMITMENTS AND CONTINGENCIES

Grant Programs

The City participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable at September 30, 2017, may be impaired. In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying combined financial statements for such contingencies.

NOTE 12: FUND BALANCES

The following is a detail of the governmental fund balances as of September 30, 2017:

	<u>Governmental Fund Balances</u>			<u>Total</u>
	<u>Nonspendable</u>	<u>Restricted</u>	<u>Unassigned</u>	
General				
Inventory	\$ 6,292	\$ -	\$ -	\$ 6,292
Unassigned	-	-	696,564	696,564
Nonmajor Governmental				
Retirement of long-term debt	-	89,038	-	89,038
Municipal court	-	36,030	-	36,030
State and federal grant programs	-	231,218	-	231,218
Public safety	-	8,506	-	8,506
Tourism	-	82,446	-	82,446
	<u>\$ 6,292</u>	<u>\$ 447,238</u>	<u>\$ 696,564</u>	<u>\$ 1,150,094</u>

NOTE 13 TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM

1. Plan Description

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

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

2. Benefits Provided

Senate Bill 411, 65th Legislature, Regular Session (1977), created TESRS and established the applicable benefit provisions. The 79th Legislature, Regular Session (2005), re-codified the provisions and gave the TESRS Board of Trustees authority to establish vesting requirements, contribution levels, benefit formulas, and eligibility requirements by board rule. The benefit provisions include

retirement benefits as well as death and disability benefits. Members are 50% vested after the tenth year of service, with the vesting percent increasing 10% for each of the next five years of service so that a member becomes 100% vested with 15 years of service.

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

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

3. Covered Membership

At August 31, 2016, TESRS membership consisted of:

Retirees & Beneficiaries Currently Receiving Benefits	3,104
Terminated Members Entitled to Benefits, but not yet receiving them	2,208
Active Participants (Vested and Nonvested)	4,046

4. Funding Policy

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

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

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

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

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

5. Contributions Required and Contributions Made

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

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

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

6. Actuarial Assumptions

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

Total pension Liability	\$ 129,121,466
Plan fiduciary net position	105,119,788
System's net pension liability	<u>\$ 24,001,678</u>

Plan fiduciary net position as a percentage of the total pension liability	81.4%
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The total pension liability in the August 31, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

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

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

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

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

7. Discount Rate

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

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

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

	1% Decrease	Current Discount Rate	1% Increase
	6.75%	7.75%	8.75%
System's net pension liability	\$ 44,821,241	\$ 24,001,678	\$ 10,867,631

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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, 2017

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
REVENUES				
Taxes				
Ad valorem taxes	\$ 1,503,300	\$ 1,473,300	\$ 1,471,079	\$ (2,221)
Other taxes	606,100	636,100	630,338	(5,762)
Licenses and permits	29,600	33,600	32,322	(1,278)
Intergovernmental	37,750	163,248	164,397	1,149
Charges for services	500	500	-	(500)
Fines and forfeitures	80,000	116,000	123,355	7,355
Investment income	1,500	4,500	4,663	163
Miscellaneous	174,300	346,650	318,362	(28,288)
Total revenues	<u>2,433,050</u>	<u>2,773,898</u>	<u>2,744,516</u>	<u>(29,382)</u>
EXPENDITURES				
Current				
General government	721,390	726,860	718,000	8,860
Public safety	1,120,640	1,246,368	1,241,071	5,297
Public works	424,000	777,250	796,248	(18,998)
Special services	145,350	142,850	138,920	3,930
Health and welfare	48,270	52,070	49,126	2,944
Debt service	-	-	-	-
Total expenditures	<u>2,459,650</u>	<u>2,945,398</u>	<u>2,943,365</u>	<u>2,033</u>
Excess (deficiency) of revenues over expenditures	(26,600)	(171,500)	(198,849)	(27,349)
OTHER FINANCING SOURCES (USES)				
Transfers in	158,600	158,600	158,600	-
Transfers out	(132,000)	(194,400)	(194,391)	9
Total other financing sources (uses)	<u>26,600</u>	<u>(35,800)</u>	<u>(35,791)</u>	<u>9</u>
Net change in fund balance	-	(207,300)	(234,640)	(27,340)
Fund balance at beginning of year	937,496	937,496	937,496	-
Fund balance at end of year	<u>\$ 937,496</u>	<u>\$ 730,196</u>	<u>\$ 702,856</u>	<u>\$ (27,340)</u>

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

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

Last 10 Years (will ultimately be displayed)

	2014	2015	2016
Total pension liability			
Service Cost	\$ 218,395	237,274	246,872
Interest (on the Total Pension Liability)	346,962	357,969	375,955
Changes of Benefit Terms	-	-	
Difference between expected and actual experience	(222,073)	(4,265)	(12,388)
Changes of assumptions	-	68,643	-
Benefit payments, including refunds of employee contributions	(186,200)	(204,755)	(212,348)
Net Change in Total Pension Liability	157,084	454,866	398,091
Total Pension Liability - Beginning	4,940,499	5,097,583	5,552,449
Total Pension Liability - Ending (a)	<u>\$ 5,097,583</u>	<u>\$ 5,552,449</u>	<u>\$ 5,950,540</u>
Plan Fiduciary Net Position			
Contributions - Employer	216,636	241,493	231,331
Contributions - Employee	93,321	98,454	96,273
Net Investment Income	194,333	5,478	259,913
Benefit payments, including refunds of employee contributions	(186,200)	(204,755)	(212,348)
Administrative Expense	(2,028)	(3,336)	(2,938)
Other	(167)	(165)	(158)
Net Change in Plan Fiduciary Net Position	315,895	137,169	372,073
Plan Fiduciary Net Position - Beginning	3,396,213	3,712,108	3,849,277
Plan Fiduciary Net Position - Ending (b)	<u>\$ 3,712,108</u>	<u>\$ 3,849,277</u>	<u>\$ 4,221,350</u>
Net Pension Liability - Ending (a) - (b)	1,385,475	1,703,172	1,729,190
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	72.82%	69.33%	70.94%
Covered Employee Payroll	\$ 1,333,150	\$ 1,406,483	\$ 1,375,334
Net Pension Liability as a Percentage of Covered Employee Payroll	103.92%	121.09%	125.73%

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

Schedule of Employer Contributions

Last ten years

	2015	2016	2017
Actuarially Determined Contribution	\$ 229,252	\$ 228,157	\$ 234,494
Contribution in relation to the actuarially determined contribution	<u>(233,693)</u>	<u>(241,493)</u>	<u>(231,331)</u>
Contribution Deficiency (excess)	<u>\$ (4,441)</u>	<u>\$ (13,336)</u>	<u>\$ 3,163</u>
Covered employee payroll	\$ 1,423,754	\$ 1,406,483	\$ 1,375,334

Contributions as a percentage of coverage employee payroll

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

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

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

	Fiscal Year Ending			
	8/31/2014	8/31/2015	8/31/2016	8/31/2017
1. Total Pension Liability				
a. Service cost	\$ 1,827,592	\$ 1,694,230	\$ 1,694,230	\$ 1,593,479
b. Interest	8,051,287	8,470,723	8,901,986	9,468,133
c. Changes of benefit terms	-	-	722,024	-
d. Differences between expected and actual experience	-	-	64,648	-
e. Assumption changes	-	-	890,002	-
f. Benefit payments	<u>(4,168,134)</u>	<u>(4,498,761)</u>	<u>(4,701,770)</u>	<u>(5,032,257)</u>
g. Net Change	5,710,745	5,666,192	7,571,120	6,029,355
h. Total - Beginning	<u>104,144,054</u>	<u>109,854,799</u>	<u>115,520,991</u>	<u>123,092,111</u>
i. Total - Ending	\$ 109,854,799	\$ 115,520,991	\$ 123,092,111	\$ 129,121,466
2. Plan Fiduciary Net Position				
a. Contributions for participating departments	\$ 4,176,659	\$ 3,515,546	\$ 3,463,603	\$ 5,012,131
b. Contributions by the state	1,530,343	1,637,308	1,583,825	1,583,825
c. Net investment income	11,908,321	(3,292,889)	4,956,730	9,776,395
d. Benefit payments	(4,168,134)	(4,498,761)	(4,701,770)	(5,032,257)
e. Administrative expenses	<u>(165,669)</u>	<u>(215,900)</u>	<u>(166,840)</u>	<u>(184,314)</u>
f. Net Change	13,281,520	(2,854,696)	5,135,548	11,155,780
g. Total - Beginning	<u>78,401,636</u>	<u>91,683,156</u>	<u>88,828,460</u>	<u>93,964,008</u>
h. Total - Ending	\$ 91,683,156	\$ 88,828,460	\$ 93,964,008	\$ 105,119,788
3. System's Net Pension Liability - Ending [Item 1 (i) - 2(h)]	18,171,643	26,692,531	29,128,103	24,001,678
4. Plan Fiduciary Net Position as a Percent of the Total Pension Liability	83.5%	76.9%	76.3%	81.4%
5. Number of Active Members	4,036	4,036	3,634	4,046
6. System's Net Pension Liability per Active Member	\$ 4,502	\$ 6,614	\$ 8,015	\$ 5,932

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

Fiscal Year Ending	Annual Money-Weighted Net Real Rate of Return
August 31, 2013	13.84%
August 31, 2014	14.92%
August 31, 2015	-3.58%
August 31, 2016	5.57%
August 31, 2017	10.32%

CITY OF PALACIOS, TEXAS
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
 September 30, 2017

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, 2017 the City complied with budgetary restrictions at all departmental levels except the following. The following table details these variances:

<u>Final</u> <u>General Fund - Department</u>	<u>Budget</u>	<u>Negative</u> <u>Actual</u>	<u>Variance</u>
Mayor and City Council	\$28,550	\$28,595	\$(45)
Parks and Maintenance	\$331,000	\$345,962	\$(14,962)
Streets	\$446,250	\$450,286	\$(4,036)

NOTE 3. TEXAS MUNICIPAL RETIREMENT SYSTEM

Valuation Date

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

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

CITY OF PALACIOS, TEXAS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

September 30, 2017

NOTE 4. TEXAS EMERGENCY SERVICES RETIREMENT SYSTEM

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

COMBINING AND INDIVIDUAL FUND STATEMENTS AND SCHEDULES

CITY OF PALACIOS, TEXAS
NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
September 30, 2017

	Special Revenue Funds		
	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
ASSETS			
Cash and cash equivalents	\$ 71,489	\$ -	\$ 304,204
Receivables (net)			
Taxes	13,457	-	-
Other	-	-	-
Due from other funds	-	-	-
Total assets	<u>\$ 84,946</u>	<u>\$ -</u>	<u>\$ 304,204</u>
LIABILITIES AND FUND BALANCES			
Liabilities			
Accounts payable	\$ 2,500	\$ -	\$ 16,955
Due to other funds	-	-	-
Deferred revenue	-	-	-
Due to other governments	-	-	-
Total liabilities	<u>2,500</u>	<u>-</u>	<u>16,955</u>
DEFERRED INFLOWS OF RESOURCES			
Unearned revenues	-	-	-
Total Deferred Inflows of Resources	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances			
Restricted			
Public safety	-	-	-
Tourism	82,446	-	-
State and federal grant programs	-	-	287,249
Municipal court	-	-	-
Debt service	-	-	-
Total fund balances	<u>82,446</u>	<u>-</u>	<u>287,249</u>
Total liabilities and fund balances	<u>\$ 84,946</u>	<u>\$ -</u>	<u>\$ 304,204</u>

The accompanying notes are an integral part of this statement.

Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency
\$ -	\$ 18,420	\$ 17,610	\$ 11,138	\$ 2,170
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
<u>\$ -</u>	<u>\$ 18,420</u>	<u>\$ 17,610</u>	<u>\$ 11,138</u>	<u>\$ 2,170</u>
\$ -	\$ -	\$ -	\$ -	\$ -
1,275	-	-	-	-
-	-	-	-	-
-	-	-	4,802	-
<u>1,275</u>	<u>-</u>	<u>-</u>	<u>4,802</u>	<u>-</u>
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	6,336	2,170
-	-	-	-	-
(1,275)	-	-	-	-
-	18,420	17,610	-	-
-	-	-	-	-
<u>(1,275)</u>	<u>18,420</u>	<u>17,610</u>	<u>6,336</u>	<u>2,170</u>
<u>\$ -</u>	<u>\$ 18,420</u>	<u>\$ 17,610</u>	<u>\$ 11,138</u>	<u>\$ 2,170</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS
NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
September 30, 2017

	Disaster Recovery Fund	Debt Service Fund	Total
ASSETS			
Cash and cash equivalents	\$ 1,500	\$ 88,781	\$ 515,312
Receivables (net)			
Taxes	-	773	14,230
Other	-	19	19
Due from other funds	-	238	238
Total assets	<u>\$ 1,500</u>	<u>\$ 89,811</u>	<u>\$ 529,799</u>
LIABILITIES AND FUND BALANCES			
Liabilities			
Accounts payable	\$ 23,536	\$ -	\$ 42,991
Due to other funds	32,720	-	33,995
Deferred revenue	-	-	-
Due to other governments	-	-	4,802
Total liabilities	<u>56,256</u>	<u>-</u>	<u>81,788</u>
DEFERRED INFLOWS OF RESOURCES			
Unearned revenues	-	773	773
Total Deferred Inflows of Resources	<u>-</u>	<u>773</u>	<u>773</u>
Fund balances			
Restricted			
Public safety	-	-	8,506
Tourism	-	-	82,446
State and federal grant programs	(54,756)	-	231,218
Municipal court	-	-	36,030
Debt service	-	89,038	89,038
Total fund balances	<u>(54,756)</u>	<u>89,038</u>	<u>447,238</u>
Total liabilities and fund balances	<u>\$ 1,500</u>	<u>\$ 89,811</u>	<u>\$ 529,799</u>

(concluded)

The accompanying notes are an integral part of this statement.

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CITY OF PALACIOS, TEXAS*NONMAJOR GOVERNMENTAL FUNDS**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**For the year ended September 30, 2017*

	Special Revenue Funds		
	Hotel Motel Tax	TCDP Sewer Project	Pavilion Restoration Fund
REVENUES			
Taxes			
Hotel - motel tax	\$ 34,134	\$ -	\$ -
Ad valorem taxes	-	-	-
Court fees	-	-	-
Intergovernmental	-	273,430	29,500
Investment income			
Interest	187	-	993
Miscellaneous	-	-	569,779
Total revenues	<u>34,321</u>	<u>273,430</u>	<u>600,272</u>
EXPENDITURES			
Current			
General government			
Promotional expense	15,635	-	-
Public works	-	325,930	998,927
Principal			
Interest	-	-	-
Total expenditures	<u>15,635</u>	<u>325,930</u>	<u>998,927</u>
Excess (deficiency) of revenues over expenditures	18,686	(52,500)	(398,655)
OTHER FINANCING SOURCES (USES)			
Proceeds from Debt			700,000
Transfers in (out)	(8,000)	52,500	-
Total other financing sources (uses)	<u>(8,000)</u>	<u>-</u>	<u>700,000</u>
Net change in fund balances	10,686	(52,500)	301,345
Fund balances at beginning of year (as restated)	<u>71,760</u>	<u>-</u>	<u>(14,096)</u>
Fund balances at end of year	<u>\$ 82,446</u>	<u>\$ (52,500)</u>	<u>\$ 287,249</u>

Special Revenue Funds

TDHCA Home Program	Court Technology	Court Security	Forfeiture Funds	Judicial Efficiency
\$ -	\$ -	\$ -	\$ -	\$ -
-	-	-	-	-
-	4,181	3,136	-	155
-	-	-	-	-
-	32	33	13	4
-	-	-	-	-
<u>-</u>	<u>4,213</u>	<u>3,169</u>	<u>13</u>	<u>159</u>
-	-	-	-	-
-	-	915	500	-
-	-	-	-	-
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>915</u>	<u>500</u>	<u>-</u>
-	4,213	2,254	(487)	159
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
-	4,213	2,254	(487)	159
<u>(1,275)</u>	<u>14,207</u>	<u>15,356</u>	<u>6,823</u>	<u>2,011</u>
<u>\$ (1,275)</u>	<u>\$ 18,420</u>	<u>\$ 17,610</u>	<u>\$ 6,336</u>	<u>\$ 2,170</u>

CITY OF PALACIOS, TEXAS

NONMAJOR GOVERNMENTAL FUNDS

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

For the year ended September 30, 2017

	Disaster Recovery Fund	Debt Service Fund	Total
REVENUES			
Taxes			
Hotel - motel tax	\$ -	\$ -	\$ 34,134
Ad valorem taxes	-	1,136	1,136
Court fees	-	-	7,472
Intergovernmental	-	-	302,930
Investment income			
Interest	-	179	1,441
Miscellaneous	-	-	569,779
Total revenues	<u>-</u>	<u>1,315</u>	<u>916,892</u>
EXPENDITURES			
Current			
General government			
Promotional expense	24,649	-	41,699
Public works	31,607	-	1,356,464
Principal	-	-	-
Interest	-	-	-
Total expenditures	<u>56,256</u>	<u>-</u>	<u>1,398,163</u>
Excess (deficiency) of revenues over expenditures	(56,256)	1,315	(481,271)
OTHER FINANCING SOURCES (USES)			
Proceeds from Debt			700,000
Transfers in (out)	-	-	44,500
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>744,500</u>
Net change in fund balances	(56,256)	1,315	263,229
Fund balances at beginning of year (as restated)	<u>1,500</u>	<u>87,723</u>	<u>184,009</u>
Fund balances at end of year	<u>\$ (54,756)</u>	<u>\$ 89,038</u>	<u>\$ 447,238</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, 2017

With comparative totals for September 30, 2016

	2017	2016
ASSETS		
Cash and cash equivalents	\$ 614,042	\$ 783,739
Receivables (net)		
Accounts	15,548	24,687
Taxes	297,565	286,015
Fines	88,549	84,746
Due from other governments	86,660	111,640
Due from other funds	87,389	88,290
Inventory	6,292	12,667
Total assets	<u>\$ 1,196,045</u>	<u>\$ 1,391,784</u>
LIABILITIES AND FUND BALANCES		
Liabilities		
Accounts payable	\$ 35,122	\$ 24,483
Accrued expenses	45,714	44,959
Due to other funds	238	238
Due to other governments	21,783	12,224
Total liabilities	<u>102,857</u>	<u>81,904</u>
DEFERRED INFLOWS OF RESOURCES		
Unearned revenues	390,332	372,384
Total Deferred Inflows of Resources	<u>390,332</u>	<u>372,384</u>
Fund balances		
Nonspendable	6,292	12,667
Unassigned	696,564	924,829
Total fund balances	<u>702,856</u>	<u>937,496</u>
Total liabilities and fund balances	<u>\$ 1,196,045</u>	<u>\$ 1,391,784</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, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
REVENUES					
Ad valorem taxes					
Current and delinquent taxes	\$ 1,440,300	\$ 1,430,300	\$ 1,435,130	\$ 4,830	\$ 1,463,392
Penalty and interest	60,000	40,000	35,159	(4,841)	102,275
Tax certificates, other fees	3,000	3,000	790	(2,210)	2,590
Total ad valorem taxes	<u>1,503,300</u>	<u>1,473,300</u>	<u>1,471,079</u>	<u>(2,221)</u>	<u>1,568,257</u>
Other taxes					
Sales tax	300,000	320,000	318,432	(1,568)	327,376
Property tax reduction sales tax	150,000	160,000	159,216	(784)	163,688
Franchise tax	150,000	150,000	147,156	(2,844)	146,546
Bingo tax	100	100	44	(56)	78
Mixed beverage tax	6,000	6,000	5,490	(510)	5,988
Total other taxes	<u>606,100</u>	<u>636,100</u>	<u>630,338</u>	<u>(5,762)</u>	<u>643,676</u>
Licenses and permits					
Building and moving permits	18,300	22,300	22,227	(73)	23,386
Dog licenses	11,300	11,300	10,095	(1,205)	8,100
Total licenses and permits	<u>29,600</u>	<u>33,600</u>	<u>32,322</u>	<u>(1,278)</u>	<u>31,486</u>
Intergovernmental					
Grant proceeds	37,750	163,248	164,397	1,149	51,089
Charges for services					
Weedy lot mowing	500	500	-	(500)	-
Economic development	-	-	-	-	-
Total charges for services	<u>500</u>	<u>500</u>	<u>-</u>	<u>(500)</u>	<u>-</u>
Fines and forfeitures					
Fines and court costs	80,000	116,000	123,355	7,355	92,385
Investment income					
Interest	1,500	4,500	4,663	163	2,686
Miscellaneous					
Insurance reimbursement	25,000	30,400	30,373	(27)	29,439
Maintenance contract	50,000	50,000	50,000	-	50,000
Other	99,300	266,250	237,989	(28,261)	73,850
Total miscellaneous	<u>174,300</u>	<u>346,650</u>	<u>318,362</u>	<u>(28,288)</u>	<u>153,289</u>
Total revenues	<u>2,433,050</u>	<u>2,773,898</u>	<u>2,744,516</u>	<u>(29,382)</u>	<u>2,542,868</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
EXPENDITURES					
General government					
Mayor and city council					
Salaries and wages	\$ 20,400	\$ 20,400	\$ 22,100	\$ (1,700)	\$ 20,200
Office supplies	1,400	1,400	1,412	(12)	1,262
Special services	1,800	1,800	451	1,349	55
Travel, training, and dues	3,200	3,200	2,928	272	3,137
Social security tax	1,650	1,650	1,652	(2)	1,637
Employee benefits	100	100	52	48	55
Capital outlay	-	-	-	-	-
Total mayor and city council	<u>28,550</u>	<u>28,550</u>	<u>28,595</u>	<u>(45)</u>	<u>26,346</u>
Elections					
Office supplies	1,500	1,970	1,969	1	70
Special services	<u>800</u>	<u>3,450</u>	<u>3,441</u>	<u>9</u>	<u>-</u>
Total elections	<u>2,300</u>	<u>5,420</u>	<u>5,410</u>	<u>10</u>	<u>70</u>
Administrative					
Salaries and wages	298,900	311,900	311,737	163	289,563
Office supplies	8,700	12,500	12,457	43	7,584
Maintenance - office equipment	29,500	25,300	23,312	1,988	28,625
Maintenance - buildings	5,000	2,000	1,966	34	1,065
Telephone	6,000	6,000	6,359	(359)	5,726
Electricity	3,300	4,300	4,297	3	3,317
Gas	480	480	486	(6)	440
Professional fees	53,500	50,000	48,639	1,361	33,857
Special services	5,000	3,000	2,987	13	6,499
Travel, training, and dues	11,500	8,000	7,426	574	4,876
Social security tax	23,800	23,800	23,281	519	21,570
Employee benefits	110,400	110,400	110,236	164	93,165
Capital outlay	-	-	-	-	19,000
Total administrative	<u>556,080</u>	<u>557,680</u>	<u>553,183</u>	<u>4,497</u>	<u>515,287</u>
Legal					
Special services	<u>8,000</u>	<u>8,000</u>	<u>3,750</u>	<u>4,250</u>	<u>1,733</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
General government - (continued)					
Corporation court					
Salaries and wages	\$ 68,680	\$ 69,280	\$ 69,173	\$ 107	\$ 68,751
Office supplies	300	400	384	16	392
Maintenance - office equipment	5,500	5,550	5,543	7	5,314
Telephone	80	80	92	(12)	83
Special services	500	250	221	29	216
Travel, training, and dues	2,000	2,250	2,233	17	1,937
Social security tax	5,300	5,300	5,236	64	5,168
Employee benefits	14,100	14,100	14,180	(80)	13,815
Capital outlay	-	-	-	-	-
Total corporation court	<u>96,460</u>	<u>97,210</u>	<u>97,062</u>	<u>148</u>	<u>95,676</u>
Library					
Special services	<u>30,000</u>	<u>30,000</u>	<u>30,000</u>	<u>-</u>	<u>30,000</u>
Total general government	<u>721,390</u>	<u>726,860</u>	<u>718,000</u>	<u>8,860</u>	<u>669,112</u>
Public safety					
Police department					
Salaries and wages	700,700	724,000	722,937	1,063	752,944
Minor tools	6,000	4,600	4,265	335	4,604
Office supplies	5,000	10,000	9,870	130	2,884
Clothing	3,000	2,000	1,680	320	1,330
Maintenance - buildings	800	-	-	-	-
Maintenance - radios/radar	29,760	29,760	29,110	650	32,709
Maintenance - office equipment	7,400	5,600	5,452	148	5,543
Telephone, electricity, and gas	14,880	17,680	17,789	(109)	16,831
Special services	2,100	1,100	673	427	6,993
Travel, training, and dues	7,500	5,300	4,650	650	4,582
Support of prisoners	500	500	122	378	262
Social security tax	54,000	54,000	53,779	221	55,748
Employee benefits	243,000	237,500	238,218	(718)	231,146
Capital outlay	-	103,498	103,498	-	-
Total police department	<u>1,074,640</u>	<u>1,195,538</u>	<u>1,192,043</u>	<u>3,495</u>	<u>1,115,576</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
Public safety - (continued)					
Fire department					
Supplies	\$ 11,500	\$ 9,250	\$ 9,173	\$ 77	\$ 10,341
Chemicals	-	-	-	-	-
Maintenance - equipment	6,000	3,100	2,070	1,030	3,935
Maintenance - buildings	1,000	-	-	-	-
Maintenance - radios	-	-	-	-	-
Telephone	1,000	1,000	453	547	1,206
Electricity	1,500	1,500	1,081	419	1,353
Gas	400	480	462	18	426
Travel, training, and dues	-	-	-	-	-
Special services	4,000	14,900	14,830	70	11,016
Employee benefits	20,600	20,600	20,959	(359)	22,543
Capital outlay	-	-	-	-	-
Total fire department	<u>46,000</u>	<u>50,830</u>	<u>49,028</u>	<u>1,802</u>	<u>50,820</u>
Total public safety	<u>1,120,640</u>	<u>1,246,368</u>	<u>1,241,071</u>	<u>5,297</u>	<u>1,166,396</u>
Public works					
Park maintenance					
Salaries	53,000	48,000	47,372	628	28,496
Tools and supplies	6,800	8,700	8,260	440	7,339
Chemicals	-	-	-	-	-
Reconstruction materials	25,000	23,100	37,598	(14,498)	35,660
Electricity	16,000	9,000	8,762	238	7,366
Special services	67,000	71,000	73,971	(2,971)	77,270
Employee Benefit	30,700	27,000	25,859	1,141	13,358
Capital outlay	-	144,200	144,140	60	27,435
Total park maintenance	<u>198,500</u>	<u>331,000</u>	<u>345,962</u>	<u>(14,962)</u>	<u>196,924</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
EXPENDITURES - (CONTINUED)					
Public works - (continued)					
Streets					
Salaries and wages	\$ 35,500	\$ 35,600	\$ 34,479	\$ 1,121	\$ 21,564
Tools and supplies	3,000	3,200	9,390	(6,190)	(2,863)
Chemicals	2,500	1,000	355	645	419
Clothing	400	500	471	29	-
Maintenance - radios	100	-	-	-	-
Reconstruction materials	47,700	48,050	48,879	(829)	59,518
Pipe and culverts	15,000	5,000	4,443	557	9,315
Electricity	40,000	44,400	44,327	73	43,482
Special services	15,000	85,200	85,109	91	84,822
Social security tax	2,700	2,700	2,661	39	1,540
Employee benefits	13,600	13,600	13,525	75	8,649
Capital outlay	50,000	207,000	206,647	353	-
Total streets	<u>225,500</u>	<u>446,250</u>	<u>450,286</u>	<u>(4,036)</u>	<u>226,446</u>
Total public works	<u>424,000</u>	<u>777,250</u>	<u>796,248</u>	<u>(18,998)</u>	<u>423,370</u>
Health and welfare					
Animal control					
Salaries	16,700	16,900	16,612		
Supplies	3,900	3,300	1,918	1,382	1,752
Telephone	800	850	826	24	879
Electricity	1,200	1,550	1,499	51	1,448
Special services	1,000	1,000	640	360	1,690
Travel, training, and dues	1,000	1,000	689	311	104
Social security tax	1,300	1,300	1,236	64	
Employee benefits	6,700	6,700	6,619	81	-
Total animal control	<u>32,600</u>	<u>32,600</u>	<u>30,039</u>	<u>2,273</u>	<u>5,873</u>
Recycling center					
Salaries and wages	8,800	8,800	8,677	123	8,884
Tools and supplies	1,720	2,280	2,217	63	1,432
Telephone	700	700	734	(34)	699
Electricity	800	800	805	(5)	1,047
Special services	600	3,940	3,885	55	1,863
Travel, training, and dues	750	650	591	59	171
Social security tax	700	700	653	47	666
Employee benefits	1,600	1,600	1,525	75	1,508
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total recycling center	<u>15,670</u>	<u>19,470</u>	<u>19,087</u>	<u>383</u>	<u>16,270</u>
Total health and welfare	<u>48,270</u>	<u>52,070</u>	<u>49,126</u>	<u>2,656</u>	<u>22,143</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS

MAJOR GOVERNMENTAL FUNDS - GENERAL FUND

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

BUDGET (GAAP BASIS) AND ACTUAL

For the year ended September 30, 2017

With comparative totals for the year ended September 30, 2016

	2017			Variance Positive (Negative)	2016
	Original Budget	Final Budget	Actual		Actual
Special services					
Unemployment	\$ 4,000	\$ -	\$ -	\$ -	\$ 6,128
Note principal	-	-	-	-	-
Bayside	35,350	35,350	35,350	-	44,190
Hospital assistance	10,000	10,000	10,000	-	10,000
Mayors Contingency	5,000	5,000	2,457	2,543	889
Insurance and bonds	90,000	90,000	89,262	738	83,927
Community improvements	1,000	2,500	1,851	649	560
Total special services	<u>145,350</u>	<u>142,850</u>	<u>138,920</u>	<u>3,930</u>	<u>145,694</u>
Total expenditures	<u>2,459,650</u>	<u>2,945,398</u>	<u>2,943,365</u>	<u>1,745</u>	<u>2,426,715</u>
Excess (deficiency) of revenues over expenditures	(26,600)	(171,500)	(198,849)	(27,637)	116,153
OTHER FINANCING SOURCES (USES)					
Transfers in	158,600	158,600	158,600	-	158,600
Transfers out	<u>(132,000)</u>	<u>(194,400)</u>	<u>(194,391)</u>	<u>9</u>	<u>(141,783)</u>
Total other financing sources (uses)	<u>26,600</u>	<u>(35,800)</u>	<u>(35,791)</u>	<u>9</u>	<u>16,817</u>
Net change in fund balance	-	(207,300)	(234,640)	(27,628)	132,970
Fund balance at beginning of year	<u>937,496</u>	<u>937,496</u>	<u>937,496</u>	<u>-</u>	<u>804,526</u>
Fund balance at end of year	<u>\$ 937,496</u>	<u>\$ 730,196</u>	<u>\$ 702,856</u>	<u>\$ (27,628)</u>	<u>\$ 937,496</u>

(concluded)

The accompanying notes are an integral part of this statement.

ENTERPRISE FUNDS

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

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

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

CITY OF PALACIOS, TEXAS**MAJOR ENTERPRISE FUND - WATER AND SEWER FUND****STATEMENT OF NET POSITION**

September 30, 2017

With comparative totals for September 30, 2017

	2017	2016
ASSETS		
Current assets		
Cash and cash equivalents	\$ 362,727	\$ 376,492
Receivables		
Accounts	494,648	477,890
Other	429	678
Allowance for uncollectible accounts	(165,725)	(166,617)
Due from other funds	-	-
Inventory	50,231	52,823
Total current assets	<u>742,310</u>	<u>741,266</u>
Noncurrent assets		
Capital assets		
Office equipment and furniture	47,715	47,715
Machinery and equipment	940,402	940,402
Service delivery system	22,969,507	22,969,507
Buildings and fixtures	3,445,718	3,404,639
Land structured facilities	760,184	760,184
Total capital assets	28,163,526	28,122,447
Accumulated depreciation	(11,301,674)	(10,616,001)
Subtotal	16,861,852	17,506,446
Land	8,129	8,129
Construction in progress	378,130	52,200
Net capital assets	17,248,111	17,566,775
Deferred expenses (net)	16,317	26,913
Total noncurrent capital assets	<u>17,264,428</u>	<u>17,593,688</u>
Total assets	<u>18,006,738</u>	<u>18,334,954</u>
DEFERRED OUTFLOWS OF RESOURCES		
Contributions after 12/31/16 through 9/30/17	118,276	98,062
Total Deferred Outflows of Resources	<u>118,276</u>	<u>98,062</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS**MAJOR ENTERPRISE FUND - WATER AND SEWER FUND****STATEMENT OF NET POSITION**

September 30 2017

With comparative totals for September 30, 2017

LIABILITIES

Current liabilities

Accounts payable	74,540	74,308
Accrued expenses	9,742	7,714
Due to other funds	46,723	46,723
Accrued interest payable	14,069	14,781
Customer meter deposits	130,628	119,688
Accrued compensated absences	5,637	12,591
Current portion of payable to developer	50,000	50,000
Current portion of general obligation bonds	200,000	190,000
Current portion of notes	88,234	88,234
Total current liabilities	<u>619,573</u>	<u>604,039</u>

Noncurrent liabilities

Net Pension Liability	423,602	397,858
Notes payable	176,468	264,702
General obligation bonds	-	-
Certificates of obligation	2,645,000	2,845,000
Payable to developer	<u>753,657</u>	<u>866,048</u>
Total noncurrent liabilities	<u>3,998,727</u>	<u>4,373,608</u>
Total liabilities	<u>4,618,300</u>	<u>4,977,647</u>

DEFERRED INFLOWS OF RESOURCES

Actual expense vs. assumptions	<u>29,901</u>	<u>28,382</u>
Total Deferred inflows of Resources	<u>29,901</u>	<u>28,382</u>

NET POSITION

Invested in capital assets, net of related debt	13,337,000	13,274,923
Unrestricted	<u>139,813</u>	<u>152,064</u>
Total net position	<u>\$ 13,476,813</u>	<u>\$ 13,426,987</u>

The accompanying notes are an integral part of this statement.

CITY OF PALACIOS, TEXAS*MAJOR ENTERPRISE FUND - WATER AND SEWER FUND**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**For the year ended September 30, 2017**With comparative totals for the year ended September 30, 2017*

	2017	2016
OPERATING REVENUES		
Charges for services	\$ 1,624,369	\$ 1,704,600
OPERATING EXPENSES		
Water system	569,665	704,706
Sanitary sewer system	288,156	295,829
Solid waste	-	-
Miscellaneous	23,818	24,519
Depreciation	685,674	710,689
Amortization	-	-
Total operating expenses	<u>1,567,313</u>	<u>1,735,743</u>
Operating income (loss) before nonoperating revenues (expenses) and contributions and transfers	57,056	(31,143)
NONOPERATING REVENUES (EXPENSES)		
Investment income		
Interest	1,227	965
Connection fees	7,510	19,473
Miscellaneous income (expense)	1,945	1,356
Interest and fiscal charges	<u>(128,133)</u>	<u>(136,146)</u>
Total nonoperating revenues (expenses)	<u>(117,451)</u>	<u>(114,352)</u>
Income (loss) before contributions and transfers	(60,395)	(145,495)
Contributions and transfers		
Capital contributions	325,930	52,200
Transfers out	(328,100)	(275,600)
Transfers in	<u>112,391</u>	<u>59,783</u>
Total contributions and transfers	<u>110,221</u>	<u>(163,617)</u>
Change in net position	49,826	(309,112)
Total net position at beginning of year	<u>13,426,987</u>	<u>13,736,099</u>
Total net position at end of year	<u>\$ 13,476,813</u>	<u>\$ 13,426,987</u>

The accompanying notes are an integral part of this statement.

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

September 30, 2017

With comparative totals for September 30, 2017

	2017	2016
ASSETS		
Current assets		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	200	300
Inventory	20,384	9,120
Total current assets	<u>20,584</u>	<u>9,420</u>
Noncurrent assets		
Capital assets		
Machinery and equipment	85,462	85,462
Buildings and fixtures	66,479	66,479
Land structured facilities	1,581,337	1,581,337
Total capital assets	1,733,278	1,733,278
Accumulated depreciation	(570,009)	(523,869)
Subtotal	<u>1,163,269</u>	<u>1,209,409</u>
Construction in progress	-	-
Net capital assets	<u>1,163,269</u>	<u>1,209,409</u>
Total assets	<u>1,183,853</u>	<u>1,218,829</u>
LIABILITIES		
Accounts payable	1,171	853
Due to other funds	6,671	1,196
Total liabilities	<u>7,842</u>	<u>2,049</u>
NET POSITION		
Invested in capital assets	1,163,269	1,209,409
Unrestricted	12,742	7,371
Total net position	<u>\$ 1,176,011</u>	<u>\$ 1,216,780</u>

The accompanying notes are an integral part of this statement.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
For the year ended September 30, 2017
With comparative totals for the year ended September 30, 2017

	2017	2016
OPERATING REVENUES		
Charges for services	\$ 9,915	\$ 12,448
Rental income	13,771	14,177
Total operating revenues	<u>23,686</u>	<u>26,625</u>
OPERATING EXPENSES		
Airport expenses		
Supplies	12,883	13,850
Repairs and maintenance	10,443	3,980
Utilities	7,391	5,616
Insurance and bonds	14,753	18,165
Special items	9,931	12,372
Depreciation	46,139	46,149
Total operating expenses	<u>101,540</u>	<u>100,132</u>
Operating income (loss) before nonoperating revenues (expenses) and transfers	(77,854)	(73,507)
NONOPERATING REVENUES (EXPENSES)		
Investment income		
Interest	19	13
Miscellaneous income (expense)	13,329	7,105
Nonoperating lease income	23,737	23,737
Total nonoperating revenues (expenses)	<u>37,085</u>	<u>30,855</u>
Income (loss) before transfers	(40,769)	(42,652)
Transfers		
Transfer out	-	-
Total transfers	<u>-</u>	<u>-</u>
Change in net position	(40,769)	(42,652)
Total net position at beginning of year	<u>1,216,780</u>	<u>1,259,432</u>
Total net position at end of year	<u>\$ 1,176,011</u>	<u>\$ 1,216,780</u>

The accompanying notes are an integral part of this statement.

OVERALL COMPLIANCE AND INTERNAL CONTROL SECTION

Baker, Stogner & Associates
Certified Public Accountants

316 E. Jackson
El Campo, TX 77437

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(979) 543-6668 Fax

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

To the City Council
City of Palacios, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Palacios, Texas, as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise the City of Palacios, Texas' basic financial statements, and have issued our report thereon dated March 7, 2018.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Baker, Stogner & Associates

El Campo, Texas

March 7, 2018