

CITY OF PEÑITAS, TEXAS

ANNUAL FINANCIAL REPORT

YEAR ENDED SEPTEMBER 30, 2012

Reyna & Garza, P.L.L.C.
Certified Public Accountants

CITY OF PEÑITAS TEXAS
ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED SEPTEMBER 30, 2012

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Reyna & Garza, PLLC

Certified Public Accountants

2111 Jackson Creek Ave.

Edinburg, Texas 78539

INDEPENDENT AUDITOR'S REPORT

To the City Commission
City of Peñitas, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Peñitas, Texas as of and for the year ended September 30, 2012, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Peñitas, Texas' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Peñitas, Texas, as of September 30, 2012, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2013, on our consideration of the City of Peñitas, 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 35 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Peñitas, Texas' financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



REYNA & GARZA, PLLC
Certified Public Accountants

June 24, 2013

Management's Discussion and Analysis
CITY OF PEÑITAS, TEXAS

MANAGEMENT'S DISCUSSION AND ANALYSIS

In this section of the Annual Financial and Compliance Report, we, the managers of City of Peñitas, Texas (the "City"), discuss and analyze the City's financial performance for the fiscal year ended September 30, 2012. Please read it in conjunction with the independent auditors' report on page 1, and the City's Basic Financial Statements, which begin on page 9.

FINANCIAL HIGHLIGHTS

- The City's net assets: increased by \$ 1,640,493 as a result of this year's operations, or nearly 22 percent.
- During the year, the City had expenses that were \$ 1,710,138 less than the \$ 3,528,371 million generated in tax and other revenues for governmental programs (before special items).
- Total cost of all of the City's programs increased from \$ 1.628 million to \$ 1.818 million (or 12 percent).
- The General Fund ended the year with a deficit fund balance of \$ 25.6 thousand.
- The resources available for appropriation were \$ 179 thousand more than budgeted for the General Fund.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The government-wide financial statements include the Statement of Net Assets and the Statement of Activities on pages 9 and 10. These provide information about the activities of the City as a whole and present a longer-term view of the City's property and debt obligations and other financial matters. They reflect the flow of total economic resources in a manner similar to the financial reports of a business enterprise.

Fund financial statements starting on page 12 report the City's operations in more detail than the government-wide statements by providing information about the City's most significant funds. For governmental activities, these statements tell how services were financed in the short term as well as what resources remain for future spending. They reflect the flow of current financial resources, and supply the basis for tax levies and the appropriations budget. For proprietary activities, fund financial statements tell how goods or services of the City were sold to external customers and how the sales revenues covered the expenses of the goods or services. The remaining statements, fiduciary statements (when applicable), provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the City.

The notes to the financial statements (starting on page 17) provide narrative explanations or additional data needed for full disclosure in the government-wide statements or the fund financial statements.

The combining statements for non-major funds contain even more information about the City's individual funds.

Reporting the City as a Whole

The Statement of Net Assets and the Statement of Activities

The analysis of the City's overall financial condition and operations begins on page 9. Its primary purpose is to show whether the City is better off or worse off as a result of the year's activities. The Statement of Net Assets includes all the City's assets and liabilities at the end of the year while the Statement of Activities includes all the revenues and expenses generated by the City's operations during the year. These apply the accrual basis of accounting which is the basis used by private sector companies.

All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. All the City's assets are reported whether they serve the current year or future years. Liabilities are considered regardless of whether they must be paid in the current or future years.

These two statements report the City's net assets and changes in them. The City's net assets (the difference between assets and liabilities) provide one measure of the City's financial health, or financial position. Over time, increases or decreases in the City's net assets are one indicator of whether its financial health is improving or deteriorating. To fully assess the overall health of the City, however, you should consider non-financial factors as well, such as changes in the City's property tax base and the condition of the City's facilities.

In the Statement of Net Assets and the Statement of Activities, we divide the City into two kinds of activities:

- **Governmental activities**—Most of the City's basic services are reported here, including public safety, public works, culture and recreation, economic development and assistance, and general administration. Property taxes, sales taxes, franchise taxes, charges for services, and state and federal grants finance most of these activities.

- **Business-type activities**—The City charges a fee to “customers” to help it cover all or most of the cost of providing services such as water, sewer, and solid waste services. However, the does not report Business-type activities.

Reporting the City's Most Significant Funds

Fund Financial Statements

The fund financial statements begin on page 11 and provide detailed information about the most significant funds—not the City as a whole. Laws and/or contracts require the City to establish some funds, such as grants received under the certain programs. The City's administration establishes several other funds to help it control and manage money for particular purposes. The City's two kinds of funds—governmental and proprietary—use different accounting approaches.

Governmental funds—Most of the City's basic services are reported in governmental funds. These use modified accrual accounting (a method that measures the receipt and disbursement of cash and all other financial assets that can be readily converted to cash) and report balances that are available for future spending. The governmental fund statements provide a detailed short-term view of the City's general operations and the basic services it provides. We describe the differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation schedules following each of the fund financial statements.

Proprietary funds—The City reports the activities for which it charges users (whether outside customers or other units of the City) in proprietary funds using the same accounting methods employed in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds (one category of proprietary funds) are the business-type activities reported in the government-wide statements but containing more detail and additional information, such as cash flows. However, the City does not have any proprietary funds.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Our analysis focuses on the net assets (Table I) and changes in net assets (Table II) of the City's governmental and business-type activities.

Net assets of the City's governmental activities increased from \$ 7.432 million to \$ 9.072 million. Unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements – were \$ 121 thousand at September 30, 2012.

Table I
CITY OF PEÑITAS, TEXAS

NET ASSETS

	Governmental Activities 2012	Governmental Activities 2011	Business-type Activities 2012	Business-type Activities 2011	Total 2012	Total 2011
Current and other assets	\$ 1,465,514	\$ 1,815,663	\$ -	\$ -	\$ 1,465,514	\$ 1,815,663
Capital assets	12,547,933	10,920,568	-	-	12,547,933	10,920,568
Total assets	\$ 14,013,447	\$ 12,736,231	\$ -	\$ -	\$ 14,013,447	\$ 12,736,231
Long-term liabilities	4,098,951	3,932,998	-	-	4,098,951	3,932,998
Other liabilities	841,913	1,371,143	-	-	841,913	1,371,143
Total liabilities	\$ 4,940,864	\$ 5,304,141	\$ -	\$ -	\$ 4,940,864	\$ 5,304,141
Net Assets:						
Invested in capital assets net of related debt	\$ 8,448,982	6,773,551	\$ -	\$ -	\$ 8,448,982	6,773,551
Restricted	502,319	302,051	-	-	502,319	302,051
Unrestricted	121,282	356,488	-	-	121,282	356,488
Total net assets	\$ 9,072,583	\$ 7,432,090	\$ -	\$ -	\$ 9,072,583	\$ 7,432,090

Table II
CITY OF PEÑITAS, TEXAS

CHANGES IN NET ASSETS

	Governmental Activities 2012	Governmental Activities 2011	Business-type Activities 2012	Business-type Activities 2011	Total 2012	Total 2011
Revenues:						
Program Revenues:						
Charges for Services	\$ 229,810	\$ 255,237	\$ -	\$ -	\$ 229,810	\$ 255,237
General Revenues:						
Property Taxes	517,111	495,643	-	-	517,111	495,643
Grants	0	4,282,681	-	-	-	4,282,681
Sales Taxes	759,611	655,058	-	-	759,611	655,058
Franchise Taxes	118,663	113,370	-	-	118,663	113,370
Investment Earnings	0	509	-	-	-	509
Grant/Intergovernmental	1,832,864	442,360	-	-	1,832,864	442,360
Miscellaneous	70,312	44,479	-	-	70,312	44,479
Total Revenue	\$ 3,528,371	\$ 6,289,337	\$ -	\$ -	\$ 3,528,371	\$ 6,289,337
Expenses:						
General Government	\$ 780,180	\$ 750,555	-	-	\$ 780,180	\$ 750,555
Judicial	10,854	115,601	-	-	10,854	115,601
Public Safety	640,481	624,342	-	-	640,481	624,342
Public Works	4,676	-	-	-	4,676	-
Highways and Streets	107,498	10,555	-	-	107,498	10,555
Culture and Recreation	98,438	66,068	-	-	98,438	66,068
Libraries	0	-	-	-	0	-
Conservation & Development	0	-	-	-	0	-
Economic Development	222	28,983	-	-	222	28,983
Bond Interest & Cap Outlay	175,884	32,082	-	-	175,884	32,082
Utility Fund	0	-	-	-	0	-
Total Expenses	\$ 1,818,233	\$ 1,628,186	\$ -	\$ -	\$ 1,818,233	\$ 1,628,186
Increase in net assets before transfers and special items	1,710,138	4,661,151	-	-	1,710,138	4,661,151
Transfers	0	-	-	-	0	-
Special Items - Resources	0	-	-	-	0	-
Special Items - Prior Period Adjustments	(69,645)	(82,426)	-	-	(69,645)	(82,426)
Net assets at 10/1	\$ 7,432,090	\$ 2,853,365	\$ -	\$ -	\$ 7,432,090	\$ 2,853,365
Net assets at 9/30	\$ 9,072,583	\$ 7,432,090	\$ -	\$ -	\$ 9,072,583	\$ 7,432,090

The cost of all governmental activities this year was \$ 1.818 million. However, as shown in the Statement of Activities on pages 10, the amount that our taxpayers ultimately financed for these activities through City ad-valorem property taxes was only \$ 517 thousand because some of the costs were paid by those who directly benefited from the programs or by other governments and organizations that subsidized certain programs with grants and contributions.

THE CITY'S FUNDS

As the City completed the year, its governmental funds (as presented in the balance sheet on pages 11 and 12) reported a combined fund balance of \$.5 million, which is less than last year's total of \$.58 million.

Over the course of the year, the Council did not revise the City's budget.

The City's General Fund balance of negative \$ 25.6 thousand reported on page 11 differs from the General Fund's budgetary fund balance of \$ 791 thousand reported in the General Fund budgetary comparison schedule on page 29. This is principally due to expenditures exceeding projections across various functional categories.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the 2011-12 year, the City had \$12.548 million (net of depreciation) invested in a broad range of capital assets, including facilities, land, infrastructure, vehicles, and equipment. The most significant current year addition was approximately \$ 1.7 million in construction in progress related to water and waste water improvements.

Debt

At year-end, the City had \$ 4.1 million in bonds, capital leases, and notes outstanding versus \$4.16 million last year, a decrease of 1.4 percent.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials normally consider many factors when setting the fiscal-year budget and tax rate. One of those factors is the economy. The City's population growth during 2000–2012 minimal averaged annual gains. More recently, unemployment has remained relatively constant. This compares with the State's unemployment rate of 7.0 percent and the national rate of 8.1 percent.

These indicators were taken into account when adopting the General Fund budget for 2012/13. Amounts available for appropriation in the General Fund budget are \$ 2.29 million, an increase of 61 percent over the final 2011/12 budget of \$ 1.42 million. The City will use its revenues to

finance programs we currently offered. Budgeted expenditures are expected to increase significantly to \$2.29 million from \$.64 million in 2012. This would be due to better budgeting in the 2012/13 year.

If these estimates are realized, the City's budgetary General Fund balance is expected to remain constant by the close of 2012/13.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City's administration office, at City of Penitas, Texas.

CITY OF PENITAS
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2012

EXHIBIT A-1

	Primary Government
	Governmental Activities
ASSETS	
Cash and Cash Equivalents	\$ 646,189
Receivables (net of allowance for uncollectibles)	819,325
Capital Assets:	
Land	159,305
Infrastructure, net	1,224,484
Buildings, net	553,098
Machinery and Equipment, net	102,881
Construction in Progress	10,508,165
Total Assets	14,013,447
LIABILITIES	
Accounts Payable	472,989
Accrued Interest Payable	141,713
Deferred Revenues	227,211
Noncurrent Liabilities	
Due Within One Year	235,792
Due in More Than One Year	3,863,159
Total Liabilities	4,940,864
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	8,448,982
Restricted Net Assets	502,319
Unrestricted Net Assets	121,282
Total Net Assets	\$ 9,072,583

The notes to the Financial Statements are an integral part of this statement.

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CITY OF PENITAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2012

EXHIBIT B-1

	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
Expenses	Charges for Services	Operating Grants and Contributions	Primary Gov. Governmental Activities	
Primary Government:				
GOVERNMENTAL ACTIVITIES:				
General Government	\$ 780,180	\$ 202,020	-	\$ (578,160)
Judicial	10,854	-	-	(10,854)
Public Safety	640,481	27,790	-	(612,691)
Public Works	4,676	-	-	(4,676)
Sanitation	107,498	-	-	(107,498)
Culture and Recreation	98,438	-	-	(98,438)
Economic Development and Assistance	222	-	-	(222)
Other Debt Interest	175,884	-	-	(175,884)
Capital Outlay	-	-	1,685,090	1,685,090
TOTAL PRIMARY GOVERNMENT:	\$ 1,818,233	\$ 229,810	\$ 1,685,090	96,667
General Revenues:				
Taxes:				
Property Taxes, Ad Valorem				517,111
Sales Taxes				759,611
Franchise Taxes				118,663
Penalty and Interest				17,666
Grants and Contributions Not Restricted				147,774
Miscellaneous Revenue				52,646
Total General Revenues				1,613,471
				Change in Net Assets
				1,710,138
Net Assets--Beginning				7,432,090
Prior Period Adjustment				(69,645)
Net Assets--Ending				\$ 9,072,583

The notes to the Financial Statements are an integral part of this statement.

CITY OF PENITAS
BALANCE SHEET
GOVERNMENTAL FUNDS
SEPTEMBER 30, 2012

	General Fund	Major Sp. Rev Crime Control & Prev. Distr	Major Sp Rev Penitas EDC-4A Fund
ASSETS			
Cash and Cash Equivalents	\$ 387,011	\$ 103,450	\$ 42,828
Taxes Receivable	180,637	29,627	15,413
Allowance for Uncollectible Taxes (credit)	(4,759)	-	-
Receivables (Net)	257,662	-	-
Due from Other Funds	71,769	33,630	321,699
Total Assets	\$ 892,320	\$ 166,707	\$ 379,940
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts Payable	\$ 6,250	\$ -	\$ -
Wages and Salaries Payable	53,671	-	-
Contracts Payable	-	-	-
Retainage Payable	-	-	-
Due to Other Funds	379,403	49,978	131,246
Accrued Interest Payable	137,175	-	4,538
Deferred Revenues	341,433	-	-
Total Liabilities	917,932	49,978	135,784
Fund Balances:			
Restricted For:			
Federal & State Restrictions	-	116,729	244,156
Assigned For:			
Assigned	-	-	-
Unassigned:			
Unassigned	(25,612)	-	-
Total Fund Balances	(25,612)	116,729	244,156
Total Liabilities and Fund Balances	\$ 892,320	\$ 166,707	\$ 379,940

The notes to the Financial Statements are an integral part of this statement.

Major Sp. Rev Police Dept. Asset Forfeit	Major Sp Rev USDA Project Fund	Major Sp Rev Penitas EDC-4B Fund	Total Governmental Funds
\$ 25,166	\$ 87,734	\$ -	\$ 646,189
-	-	15,411	241,088
-	-	-	(4,759)
-	325,334	-	582,996
18,980	-	126,023	572,101
<u>\$ 44,146</u>	<u>\$ 413,068</u>	<u>\$ 141,434</u>	<u>\$ 2,037,615</u>
\$ -	\$ -	\$ -	\$ 6,250
-	-	-	53,671
-	138,502	-	138,502
-	274,566	-	274,566
11,474	-	-	572,101
-	-	-	141,713
-	-	-	341,433
<u>11,474</u>	<u>413,068</u>	<u>-</u>	<u>\$ 1,528,236</u>
-	-	141,434	502,319
32,672	-	-	32,672
-	-	-	(25,612)
<u>32,672</u>	<u>-</u>	<u>141,434</u>	<u>\$ 509,379</u>
<u>\$ 44,146</u>	<u>\$ 413,068</u>	<u>\$ 141,434</u>	<u>\$ 2,037,615</u>

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CITY OF PENITAS
 RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE
 STATEMENT OF NET ASSETS
 SEPTEMBER 30, 2012

Total Fund Balances - Governmental Funds	\$	509,379
Capital assets used in governmental activities are not financial resources and therefore are not reported in governmental funds. At the beginning of the year, the cost of these assets was \$11,821,667 and the accumulated depreciation was \$901,099. In addition, long-term liabilities, including bonds payable, are not due and payable in the current period, and, therefore are not reported as liabilities in the funds. The net effect of including the beginning balances for capital assets (net of depreciation) and long-term debt in the governmental activities is to increase (decrease) net assets.		6,756,827
Current year capital outlays and long-term debt principal payments are expenditures in the fund financial statements, but they should be shown as increases in capital assets and reductions in long-term debt in the government-wide financial statements. The net effect of including the 2011 capital outlays and debt principal payments is to increase (decrease) net assets.		1,851,813
The 2012 depreciation expense increases accumulated depreciation. The net effect of the current year's depreciation is to decrease net assets.		(159,658)
Various other reclassifications and eliminations are necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. These include recognizing deferred revenue as revenue, eliminating interfund transactions, reclassifying the proceeds of bond sales as an increase in bonds payable, and recognizing the liabilities associated with maturing long-term debt and interest. The net effect of these reclassifications and recognitions is to increase (decrease) net assets.		114,222
Net Assets of Governmental Activities	\$	9,072,583

The notes to the Financial Statements are an integral part of this statement.

CITY OF PENITAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2012

	General Fund	Major Sp. Rev Crime Control & Prev. Distr	Major Sp Rev Penitas EDC-4A Fund
REVENUES:			
Taxes:			
Property Taxes	\$ 503,045	\$ -	\$ -
General Sales and Use Taxes	381,114	187,945	95,276
Franchise Tax	118,663	-	-
Penalty and Interest on Taxes	17,666	-	-
Licenses and Permits	45,864	-	-
Intergovernmental Revenue and Grants	133,357	832	-
Charges for Services	202,020	-	-
Rents and Royalties	1,160	-	-
Contributions & Donations from Private Sources	13,585	-	-
Other Revenue	5,802	-	-
Total Revenues	<u>1,422,276</u>	<u>188,777</u>	<u>95,276</u>
EXPENDITURES:			
Current:			
General Government	1,020,260	-	1,277
Public Safety	417,917	161,220	-
Public Works	4,676	-	-
Sanitation	98,918	-	-
Culture and Recreation	90,784	-	-
Debt Service:			
Other Debt Principal	22,851	-	21,064
Other Debt Interest	1,604	-	12,728
Capital Outlay:			
Capital Outlay	-	2,500	-
Total Expenditures	<u>1,657,010</u>	<u>163,720</u>	<u>35,069</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(234,734)</u>	<u>25,057</u>	<u>60,207</u>
OTHER FINANCING SOURCES (USES):			
Transfers In	313,242	-	-
Transfers Out (Use)	(226,766)	-	-
Total Other Financing Sources (Uses)	<u>86,476</u>	<u>-</u>	<u>-</u>
Net Change in Fund Balances	(148,258)	25,057	60,207
Fund Balance - October 1 (Beginning)	192,291	91,672	183,948
Prior Period Adjustment	(69,645)	-	-
Fund Balance - September 30 (Ending)	<u>\$ (25,612)</u>	<u>\$ 116,729</u>	<u>\$ 244,155</u>

The notes to the Financial Statements are an integral part of this statement.

Major Sp. Rev Police Dept. Asset Forfeit	Major Sp Rev USDA Project Fund	Major Sp Rev Penitas EDC-4B Fund	Total Governmental Funds
\$ -	\$ -	\$ -	\$ 503,045
-	-	95,276	759,611
-	-	-	118,663
-	-	-	17,666
-	-	-	45,864
-	1,685,090	-	1,819,279
27,790	-	-	229,810
-	-	-	1,160
-	-	-	13,585
-	-	(180)	5,622
<u>27,790</u>	<u>1,685,090</u>	<u>95,096</u>	<u>3,514,305</u>
-	469	1,286	1,023,292
17,087	-	-	596,224
-	-	-	4,676
-	-	-	98,918
-	-	-	90,784
-	-	20,875	64,790
-	148,826	12,728	175,886
<u>4,000</u>	<u>1,449,320</u>	<u>-</u>	<u>1,455,820</u>
<u>21,087</u>	<u>1,598,615</u>	<u>34,889</u>	<u>3,510,390</u>
<u>6,703</u>	<u>86,475</u>	<u>60,207</u>	<u>3,915</u>
-	226,766	-	540,008
-	(313,242)	-	(540,008)
-	(86,476)	-	-
6,703	(1)	60,207	3,915
25,969	-	81,227	575,107
-	-	-	(69,645)
<u>\$ 32,672</u>	<u>\$ (1)</u>	<u>\$ 141,434</u>	<u>\$ 509,377</u>

CITY OF PENITAS
 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, 2012

Total Net Change in Fund Balances - Governmental Funds	\$	3,915
Current year capital outlays and long-term debt principal payments are expenditures in the fund financial statements, but they should be shown as increases in capital assets and reductions in long-term debt in the government-wide financial statements. The net effect of removing the 2012 capital outlays and debt principal payments is to increase (decrease) net assets.		1,851,813
Depreciation is not recognized as an expense in governmental funds since it does not require the use of current financial resources. The net effect of the current year's depreciation is to decrease net assets.		(159,658)
Various other reclassifications and eliminations are necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. These include recognizing deferred revenue as revenue, adjusting current year revenue to show the revenue earned from the current year's tax levy, eliminating interfund transactions, reclassifying the proceeds of bond sales, and recognizing the liabilities associated with maturing long-term debt and interest. The net effect of these reclassifications and recognitions is to increase (decrease) net assets.		14,068
Change in Net Assets of Governmental Activities	\$	1,710,138

The notes to the Financial Statements are an integral part of this statement.

CITY OF PEÑITAS, TX

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED SEPTEMBER 30, 2012

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The combined financial statements of the City of Peñitas, Texas (the "City") have been prepared in conformity with accounting principles applicable to governmental units which are generally accepted in the United States of America. The Governmental Accounting Standards Board ("GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

A. REPORTING ENTITY

The City's basic financial statements include the accounts of all its operations. The City evaluated whether any other entity should be included in these financial statements. The criteria for including organizations as component units within the City's reporting entity, as set forth in GASB Statement No. 14, "The Financial Reporting Entity", include whether:

- The organization is legally separate (can sue and be sued in its name)
- The City holds the corporate powers of the organization
- The City appoints a voting majority to the organization's board
- The city is able to impose its will on the organization
- The organization has the potential to impose a financial benefit/burden on the City
- There is fiscal dependency by the organization on the City
- The exclusion of the organization would result in misleading or incomplete financial statements

The City also evaluated each legally separate, tax – exempt organization whose resources are used principally to provide support to the City to determine if its omission from the reporting entity would result in financial statements that are misleading or incomplete. GASB Statement No. 14 requires inclusion of such an organization as a component unit when: 1) The economic resources received or held by the organization are entirely or almost entirely for the direct benefit of the City, its component units, or its constituents; and 2) The City or its component units is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the organization; and 3) Such economic resources are significant to the City.

Blended Component Units

Blended component units are separate legal entities that meet the component unit criteria and whose governing body is the same or substantially the same as the City Council or the component units provides services entirely to the City. These component units' funds are blended into those of the City's by appropriate activity type to compose the primary government presentation. Currently, the City's blended component is the Economic Development Corporation (EDC).

The citizens of the City voted on May 12, 2012 to incorporate the City of Peñitas, Texas. The City operates under a Home Rule Charter with a Mayor – City Council form of government and provides the following services as authorized by its charter: public improvements, utilities (water and sewer), code enforcement, judicial and election functions, and general administrative services.

B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The Statement of Net Assets and the Statement of Activities are government-wide financial statements. They report information on all of the City's nonfiduciary activities with most of the interfund activities removed. *Governmental activities* include programs supported primarily by taxes, State funds, grants and other intergovernmental revenues. *Business-type activities* include operations that rely to a significant extent on fees and charges for support.

The Statement of Activities demonstrates how other people or entities that participate in programs the City operates have shared in the payment of the direct costs. The "charges for services" column includes payments made by parties that purchase, use, or directly benefit from goods or services provided by a given function or segment of the City. The "grants and contributions" column includes amounts paid by organizations outside the City to help meet the operational or capital requirements of a given function. If a revenue is not a program revenue, it is a general revenue used to support all of the City's functions. Taxes are always general revenues.

Interfund activities between governmental funds and between governmental funds and proprietary funds appear as due to/due froms on the Governmental Fund Balance Sheet and Proprietary Fund Statement of Net Assets and as other resources and other uses on the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balance and on the Proprietary Fund Statement of Revenues, Expenses and Changes in Fund Net Assets. All interfund transactions between governmental funds are eliminated on the government-wide statements. Interfund activities between governmental funds and enterprise funds remain on the government-wide statements and appear on the government-wide Statement of Net Assets as internal balances and on the Statement of Activities as interfund transfers. Interfund activities between governmental funds and fiduciary funds remain as due to/due froms on the government-wide Statement of Activities.

The fund financial statements provide reports on the financial condition and results of operations for three fund categories - governmental, proprietary, and fiduciary. Since the resources in the fiduciary funds cannot be used for City operations, they are not included in the government-wide statements. The City considers some governmental and enterprise funds major and reports their financial condition and results of operations in a separate column.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues result from providing goods and services in connection with a proprietary fund's principal ongoing operations; they usually come from exchange or exchange-like transactions. All other revenues are nonoperating. Operating expenses can be tied specifically to the production of the goods and services, such as materials and labor and direct overhead. Other expenses are nonoperating.

C. MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION

The government-wide financial statements use the economic resources measurement focus and the accrual basis of accounting, as do the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the 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 use the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets, current liabilities and fund balances are included on the balance sheet. Operating statements of these funds present net increases and decreases in current assets (i.e., revenues and other financing sources and expenditures and other financing uses).

The modified accrual basis of accounting recognizes revenues in the accounting period in which they become both measurable and available, and it recognizes expenditures in the accounting period in which the fund liability is incurred, if measurable, except for un-matured interest and principal on long-term debt, which is recognized when due. The expenditures related to certain compensated absences and claims and judgments are recognized when the obligations are expected to be liquidated with expendable available financial resources. The City considers all revenues available if they are collectible within 60 days after year end.

Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the "susceptible to accrual" concept, that is, when they are both measurable and available. The City considers them "available" if they will be collected within 60 days of the end of the fiscal year. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available.

Grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant. Accordingly, when such funds are received, they are recorded as deferred revenues until related and authorized expenditures have been made. If balances have not been expended by the end of the project period, grantors some times require the City to refund all or part of the unused amount.

The Proprietary Fund Types and Fiduciary Funds are accounted for on a flow of economic resources measurement focus and utilize the accrual basis of accounting. This basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable and expenses in the accounting period in which they are incurred and become measurable. The City applies all GASB pronouncements as well as the Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless these pronouncements conflict or contradict GASB pronouncements. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the fund statement of Net Assets. The fund equity is segregated into invested in capital assets net of related debt, restricted net assets, and unrestricted net assets.

D. FUND ACCOUNTING

The City reports the following major governmental funds:

1. **The General Fund** – The general fund is the City's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.
2. **Special Revenue Funds** – The City accounts for resources restricted to, or designated for, specific purposes by the City or a grantor in a special revenue fund. Most Federal and some State financial assistance is accounted for in a Special Revenue Fund, and sometimes unused balances must be returned to the grantor at the close of specified project periods.

E. OTHER ACCOUNTING POLICIES

1. For purposes of the statement of cash flows for proprietary funds, the City considers highly liquid investments to be cash equivalents if they have a maturity of three months or less when purchased.
2. In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

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.

3. It is the City's policy to permit some employees to accumulate earned but unused vacation and sick pay benefits. There is a liability for unpaid accumulated vacation leave since the City does have a policy to pay any amounts when employees separate from service with the City. All vacation pay is accrued when incurred in the government-wide, proprietary, and fiduciary 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 resignations and retirements.
4. Capital assets, which include land, buildings, furniture and equipment [and infrastructure assets] are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. 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 assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Buildings, furniture and equipment of the City are depreciated using the straight line method over the following estimated useful lives. The estimated lives range from 3 to 15 years for equipment, 2 to 15 years for vehicles, 30 years for infrastructure, 20 years for improvements, and 50 years for buildings.

5. Restricted Assets-Certain proceeds of enterprise fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants.
6. Deferred revenues are those for which asset recognition criteria have been met, but for which revenue recognition criteria have not been met. Monies collected in advance from federal or state agencies are recorded as revenue in the year for which the expenditures are incurred.
7. When the City incurs an expense for which it may use either restricted or unrestricted assets, it uses the restricted assets first whenever they will have to be returned if they are not used.
8. Encumbrances-The City of Peñitas, Texas, employs encumbrance accounting; under which purchase order, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation.
9. The City has adopted GASB 54 as part of its 2010-11 fiscal year reporting. Implementation of GASB 54 is required for all cities for their fiscal year ending 2012. The intention of GASB 54 is to provide a more structured classification of fund balance and to improve the usefulness of fund balance reporting to the users of the City's financial statements. The reporting standard establishes a hierarchy for fund balance classifications and the constraints imposed on the uses of those resources. GASB 54 provides for two major types of fund balances, which are nonspendable and spendable.

Nonspendable fund balances are balances that cannot be spent because they are not expected to be converted to cash or they are legally or contractually required to remain intact. Examples of these classifications are prepaid items and inventories.

In addition to the nonspendable fund balance, GASB 54 has provided a hierarchy of spendable fund balances, based on hierarchy of spending constraints.

- Restricted: fund balances that are constrained by external parties, constitutional provisions, or enabling legislation.
- Committed: fund balances that contain self-imposed constraints of the

government form its highest level of decision making authority. The responsibility to commit funds rests with the City Commissioners. Committed amounts cannot be used for any other purpose unless the governing board removes those constraints by taking the same type of formal action.

- Assigned: fund balances that contain self-imposed constraints of the government to be used for a particular purpose.
- Unassigned: fund balance of the general fund that is not constrained for any particular purpose.

When the City incurs an expense for which it may use either restricted or unrestricted assets, it used the restricted assets first whenever they will have to be returned if they are not used.

II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

A. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN THE GOVERNMENTAL FUND BALANCE SHEET AND THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS

Exhibit C-2 provides the reconciliation between the fund balance for total governmental funds on the governmental fund balance sheet and the net assets for governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that capital assets are not financial resources and are therefore not reported in governmental funds. In addition, long-term liabilities, including bonds payable, are not due and payable in the current period and are not reported as liabilities in the funds. The details of capital assets and long-term debt at the beginning of the year were as follows:

<u>Capital Assets</u> <u>at the Beginning of the year</u>	<u>Historic Cost</u>	<u>Accumulated</u> <u>Depreciation</u>	<u>Net Value at the</u> <u>Beginning of the</u> <u>Year</u>	<u>Change in Net</u> <u>Assets</u>
Land	\$ 159,305	\$ 0	\$ 159,305	
Buildings	1,043,643	(450,500)	593,143	
Furniture & Equipment	356,585	(179,551)	177,034	
Infrastructure	1,460,983	(271,048)	1,189,935	
Construction in Progress	<u>8,801,151</u>	<u>0</u>	<u>8,801,151</u>	
Change in Net Assets				<u>\$ 10,920,568</u>
 <u>Long-term Liabilities</u> <u>at the Beginning of the year</u>			 <u>Payable at the</u> <u>Beginning of the</u> <u>Year</u>	
Capital Leases Payable			\$ 9,155	
Notes Payable			725,586	
Certificates of Obligation			<u>3,429,000</u>	
Change in Net Assets				<u>\$ (4,163,741)</u>
 Net Adjustment to Net Assets				 <u>\$ 6,756,827</u>

B. EXPLANATION OF CERTAIN DIFFERENCES BETWEEN THE GOVERNMENTAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES AND THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES

Exhibit C-4 provides a reconciliation between the net changes in fund balance as shown on the governmental fund statement of revenues, expenditures, and changes in fund balances and the changes in net assets of governmental activities as reported on the government-wide statement of activities. One element of that reconciliation explains that current year capital outlays and debt principal payments are expenditures in the fund financial statements, but should be shown as increases in capital assets and decreases in long-term debt in the government-wide statements. This adjustment affects both the net asset balance and the change in net assets. The details of this adjustment are as follows:

	<u>Amount</u>	<u>Adjustments to Changes in Net Assets</u>	<u>Adjustments to Net Assets</u>
<u>Current Year Capital Outlay</u>			
Various Categories	\$ 1,787,023	\$ 1,787,023	\$ 1,787,023
Total Capital Outlay	<u>\$ 1,787,023</u>	<u>\$ 1,787,023</u>	<u>\$ 1,787,023</u>
<u>Debt Principal Payments</u>			
Loan Principal	\$ 55,635	\$ 55,635	\$ 55,635
Capital Lease Principal	9,155	9,155	9,155
Total Principal Payments	<u>\$ 64,790</u>	<u>\$ 64,790</u>	<u>\$ 64,790</u>
Total Adjustment to Net Assets		<u>\$ 1,851,813</u>	<u>\$ 1,851,813</u>

Another element of the reconciliation on Exhibit C-4 is described as various other reclassifications and eliminations necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. This adjustment is the result of several items. The details for this element are as follows:

	<u>Amount</u>	<u>Adjustments to Change in Net Assets</u>	<u>Adjustments to Net Assets</u>
<u>Adjustments to Revenue and Deferred Revenue</u>			
Taxes Collected from Prior Year Levies	\$ 23,854	\$ (23,854)	\$ -
Uncollected taxes (assumed collectible) from Current Year Levy	\$ 42,678	\$ 42,678	\$ 42,678
Other		\$(4,758)	\$ 71,544
Total		<u>\$ 14,066</u>	<u>\$ 114,222</u>

III. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. BUDGETARY DATA

The City Council adopts an "appropriated budget" for the General Fund. In accordance with Government Accounting Standards Board (GASB) Statement#34, a City is required to present the adopted and final amended budgeted revenues and expenditures for the General Fund. The City compares the final amended budget to actual revenues and expenditures. Budget information appears in Exhibits E-1.

The following procedures are followed in establishing the budgetary data reflected in the general-purpose financial statements:

1. Prior to October 1, the City prepares a budget for the next succeeding fiscal year beginning October 1. The operating budget includes proposed expenditures and the means of financing them.

2. A meeting of the City Council is then called for the purpose of adopting the proposed budget. At least ten days' public notice of the meeting must be given.
3. Prior to October 1, the budget is legally enacted through passage of an ordinance by the Council. Once a budget is approved, it can only be formally amended by approval of a majority of the members of the Council. Amendments are presented to the Council at its regular meetings. Each amendment must have Council approval. As required by law, such amendments are made before the fact, and are reflected in the official minutes of the Council, and are not made after fiscal year end. No budget amendments occurred in 2012.
4. Budgeted amounts are as amended by the Council. All budget appropriations lapse at year end.

B. EXCESS OF EXPENDITURES OVER APPROPRIATIONS

General Fund expenditures exceeded appropriations by the amount(s) noted below;

<u>Functional Category</u>	<u>Amount</u>
General Government	\$488,112
Highways & Streets	\$ 4,676
Culture and Recreation	\$ 19,834
Debt Service-Interest	\$ 1,604

IV. DETAILED NOTES ON ALL FUNDS AND ACCOUNT GROUPS

A. DEPOSITS AND INVESTMENTS

The funds of the City must be deposited and invested under the terms of a contract, contents of which are set out in the Depository Contract Law. The depository bank places approved pledged securities for safekeeping and trust with the City's agent bank in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

At September 30, 2012, the carrying amount of the City's deposits (cash and interest-bearing savings accounts included in temporary investments) was \$646,189 and the bank balance was \$ 707,278. The City's cash deposits at September 30, 2012 and during the year ended September 30, 2012 were entirely covered by FDIC insurance or by pledged collateral held by the City's agent bank in the City's name.

The Public Funds Investment Act (Government Code Chapter 2256) contains specific provisions in the areas of investment practices, management reports and establishment of appropriate policies. Among other things, it requires the City to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on the stated maturity date for the portfolio, (8) investment staff quality and capabilities, (9) and bid solicitation preferences for certificates of deposit. Statutes authorize the City to invest in (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas; (2) certificates of deposit, (3) certain municipal securities, (4) money market savings accounts, (5) repurchase agreements, (6) bankers acceptances, (7) Mutual Funds, (8) Investment pools, (9) guaranteed investment contracts, (10) and common trust funds.

The Act also requires the City to have independent auditors perform test procedures related to investment practices as provided by the Act. The City is in substantial compliance with the requirements of the Act and with local policies.

As of September 30, 2012, the City had the following investments;

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>		
		<u>Less than 1</u>	<u>1-5</u>	<u>More Than 10</u>
<u>General Fund:</u>				
Certificate of Deposit	\$ 25,266	\$ 25,266		
Total-General Fund	\$ 25,266	\$ 25,266		
<u>Special Revenues Funds:</u>				
Certificate of Deposit	\$ 9,606	\$ 9,606		
Total-Special Revenue Fund	\$ 9,606	\$ 9,606		
Subtotal-Governmental Type	\$ 34,872	\$ 34,872		
Total-All Fund Types	\$ 34,872	\$ 34,872		

Credit Risk To limit the risk that an issuer or other counterparty to an investment will not fulfill its obligations the City limits investments to Certificates of Deposits, Public Funds Investment Pools and Guaranteed Investment Contracts, collateralized by U.S. Government Securities. As of September 30, 2012, the city's investments were secured by U.S. Government Securities.

Custodial Credit Risk for Investments State law requires governmental entities to contract with financial institutions in which funds will be deposited to secure those deposits with insurance or pledged securities with a fair value equaling or exceeding the amount on deposit at the end of each business day. The pledged securities must be in the name of the governmental entity and held by the entity or its agent. Since the city complies with this law, it has no custodial credit risk for deposits.

Concentration of Credit Risk To limit the risk of loss attributed to the magnitude of a government's investment in a single issuer, the investment portfolio shall be diversified in terms of investment instruments maturity scheduling, and financial institutions. To further limit the risk all of the City investments are collateralized by U.S. Government Securities.

Interest Rate Risk To limit the risk that changes in interest rates will adversely affect the fair value of investments, the City requires that the investments shall be monitored by using specific identification.

Foreign Currency Risk for Investments The City limits the risk that changes in exchanges rates will adversely affect the fair value of an investment. At year-end, the City was not exposed to foreign currency risk.

B. PROPERTY TAXES

Property taxes are levied by October 1 on the assessed value listed as of the prior January 1 for all real and business personal property located in the City in conformity with Subtitle E, Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. On January 31 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed. Property tax revenues are considered available (1) when they become due or past due and receivable within the current period and (2) when they are expected to be collected during a 60-day period after the close of the fiscal year.

C. DELINQUENT TAXES RECEIVABLE

Allowances for uncollectible tax receivables within the General Fund are based on historical experience in collecting property taxes. Uncollectible personal property taxes are periodically reviewed and written off, but the City is prohibited from writing off real property taxes without specific statutory authority from the Texas Legislature.

D. INTERFUND BALANCES

Balances due to and due from other funds at September 30, 2012 consisted of the following:

Due From Fund	Due To Fund	Amount	Purpose
General Fund	Special Revenue Funds	\$ 572,101	Short-term loans
Special Revenue Funds	General Fund	572,101	Short-term loans
	Total	<u>\$ 572,101</u>	

The outstanding balances between funds result mainly from time lag between the date that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made. All amounts due are scheduled to be repaid within one year.

Transfers to and from other funds during the year ended September 30, 2012 consisted of the following:

Transfers From	Transfers To	Amount	Reason
General Fund	USDA Project	\$226,766	Supplemental other funds sources
USDA Project	General Fund	313,242	Supplemental other funds sources
	Total	<u>\$540,008</u>	

E. CAPITAL ASSET ACTIVITY

Capital asset activity for the City for the year ended September 30, 2012, was as follows:

	Primary Government			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements & Adjustments</u>	<u>Ending Balance</u>
Governmental Activities:				
Land	\$ 159,305	\$ -	\$ -	\$ 159,305
Buildings	1,043,643	-	-	1,043,643
Furniture and Equipment	356,585	-	-	356,585
Infrastructure	1,460,983	80,009	-	1,540,992
Construction in Progress	<u>8,801,151</u>	<u>1,707,014</u>	-	<u>10,508,165</u>
Totals at Historic Cost	<u>\$ 11,821,667</u>	<u>\$ 1,787,023</u>	<u>\$ -</u>	<u>\$ 13,608,690</u>
Less Accumulated Depreciation:				
Total Accumulated Depreciation	<u>(901,099)</u>	<u>(159,658)</u>	<u>(-)</u>	<u>(1,060,757)</u>
Governmental Activities Capital Assets, Net	<u>\$ 10,920,568</u>	<u>\$ 1,627,365</u>	<u>\$ (-)</u>	<u>\$ 12,547,933</u>

Depreciation expense was charged to governmental functions as follows:

General Government	\$ 88,091
Judicial	10,854
Public Safety	44,257
Public Works	8,580
Economic Development	222
Culture & Recreation	<u>7,654</u>
Total Depreciation Expense	<u>\$ 159,658</u>

F. BONDS AND OTHER LONG-TERM PAYABLES

At September 30, 2012, long-term debt consisted of the following:

General Long Term Debt:

\$1,364,000 Certificate of Obligation from USDA 92-02 with annual interest rate of 3.75%; maturity date, November 1, 2050.	1,364,000
\$1,605,000 Certificate of Obligation from USDA 92-04 with annual interest rate of 4.50%; maturity date November 1, 2050.	1,605,000
Loan Certificate of Obligation from USDA 92-06 for \$460,000, with annual interest rate of 3.00%; due date on November 1, 2050.	460,000

Notes Payable:

Note payable to Lone Star National Bank for \$97,962, payable in monthly payments of \$1,987 including interest of 8.00%, secured by vehicles, due 11/2013	2,086
City of Peñitas – Economic Development Corporation - Note payable to Lone Star National Bank for \$130,000, interest payments quarterly, interest rate of 8.25%, , secured by real estate, due 2/2010	88,670
Note payable to Mil Encinos for \$625,000, interest of 3.50%.	75,000
Note payable to Texas Leverage Fund for \$550,000, payable in monthly payments of \$3,869.84 including interest of 3.25%, due 12/17/2026	504,195

Total General Long Term Debt	<u>\$ 4,098,951</u>
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Total Long-Term Debt	<u>\$ 4,098,951</u>
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There are a number of limitations and restrictions contained in the revenue bond indenture. Management has indicated that the City is in compliance with all significant limitations and restrictions at September 30, 2012.

G. DEBT SERVICE REQUIREMENTS

Debt service requirements for long-term debt are as follows:

Year Ending	Notes Payable		Certificates of Obligation	
	Principal	Interest	Principal	Interest
September 30				
2013	\$ 198,792	\$ 17,460	\$ 37,000	\$137,175
2014	31,587	14,851	39,000	135,695
2015	32,629	13,809	40,000	134,168
2016	33,705	12,733	42,000	132,578
2017	34,817	11,621	45,000	130,905

2018-2022	192,092	40,098	248,000	626,746
2023-2027	146,328	8,278	311,000	572,634
2028-2032	-	-	382,000	505,208
2033-2037	-	-	473,000	422,011
2038-2042	-	-	582,000	319,050
2043-2047	-	-	720,000	191,678
2048-2050	-	-	510,000	41,596
Total	\$ 669,951	\$ 118,850	\$ 3,429,000	\$3,349,444

H. CHANGES IN LONG-TERM LIABILITIES

Long-term activity for the year ended September 30, 2012, 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:					
Bonds and Notes Payable:					
Capital Leases	\$ 9,155	\$ -	\$ (9,155)	\$ -	\$ -
Certificates of Obligation	3,429,000	-	(-)	3,429,000	37,000
Notes Payable	725,586	-	(55,635)	669,951	198,792
Total Bonds and Notes Payable	<u>\$ 4,163,741</u>	<u>\$ -</u>	<u>\$ (64,790)</u>	<u>\$ 4,098,951</u>	<u>\$ 235,792</u>
Total Governmental Activities Long-term Liabilities	<u>\$ 4,163,741</u>	<u>\$ -</u>	<u>\$ (64,790)</u>	<u>\$ 4,098,951</u>	<u>\$ 235,792</u>

I. DEFERRED REVENUE

Deferred revenue at year-end consisted of the following:

	<u>Governmental Funds</u>	<u>Total</u>
Deferred Revenue	<u>\$341,433</u>	<u>\$341,433</u>
Total Deferred Revenue	<u>\$341,433</u>	<u>\$341,433</u>

Net uncollected tax receivables in the general fund represents the entire amount of the total amount reflected as deferred revenues.

J. RECEIVABLES AND PAYABLES

The City believes that sufficient detail of receivable and payable balances is provided in the financial statements to avoid the obscuring of significant components by aggregation. Therefore, no additional disclosure is provided which disaggregates those balances.

K. DEFICIT FUND BALANCE

The City ended the year with a deficit fund balance in the General fund. The balance at September 30, 2012 was (\$25,615).

L. COMMITMENTS AND CONTINGENCIES

The City is involved in various lawsuits concerning several issues. The city's management and legal counsel estimate that the potential loss for a number of the cases is minimal, either in the potential for an unfavorable outcome or the potential loss in the event of loss. In addition the City's legal counsel is unable to reasonably predict the outcome in favor of or against the City at this time for all the outstanding cases, and is not able to estimate a range of potential loss for all the cases.

Federal and State Funds -The City has received federal and state funds as grants and other financial assistance. These funds must be spent only as allowed by the grant and other federal or state requirements. Also, the City must follow various laws and regulations when they receive these funds. If the City does not abide by these laws and regulations or does not spend the monies, as allowed under the grant agreements, the City may be required to return the grant monies, or portion thereof, to the granting agencies. The contingent liability, if any, that may be due to the federal and state agencies, cannot be readily determined.

M. RISK MANAGEMENT

The City is exposed to various risks of loss related to torts, theft, damage, or destruction of assets, errors and omissions, injuries to employees, and natural disasters. During fiscal year 2012, the city has maintained general liability coverage at a cost that is considered to be economically justifiable by joining together with other governmental entities in the State as a member of the Texas Municipal League Intergovernmental Risk Pool ("TML"). TML is a self-funded pool operating as a common risk management and insurance program. The City pays an annual premium to TML for its insurance coverage. The agreement for the formation of TML provides that TML will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of acceptable risk levels; however each category of coverage has its own level of reinsurance. The City continues to carry commercial insurance for other risks of loss. There were no significant reductions in commercial insurance coverage in the past fiscal year and settled claims resulting from these risks have not exceeded coverage in any of the past three years.

N. CONSTRUCTION COMMITMENTS

At September 30, 2012 the City had commitments for construction costs on the sewer system improvements construction in progress. A combination of USDA grants and loans totaling \$9,900,000 have been approved for the project. As of September 30, 2012 a combination of expenditures totaling \$10,508,165 are currently recorded as construction on progress.

O. PRIOR PERIOD ADJUSTMENT

The City's net assets in the governmental fund type decreased by \$69,145. The City's General Fund fund balance also decreased by \$69,145, both due to the recognition of an addition liability due to the Texas Comptroller.

P. SUBSEQUENT EVENTS

The City considered items and events through June 26, 2013.

CITY OF PENITAS
 SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
 BUDGET AND ACTUAL - GENERAL FUND
 FOR THE YEAR ENDED SEPTEMBER 30, 2012

	Budgeted Amounts		Actual Amounts (GAAP BASIS)	Variance With Final Budget Positive or (Negative)
	Original	Final		
REVENUES:				
Taxes:				
Property Taxes	\$ 465,000	\$ 465,000	\$ 503,045	\$ 38,045
General Sales and Use Taxes	480,000	480,000	381,114	(98,886)
Franchise Tax	78,800	78,800	118,663	39,863
Penalty and Interest on Taxes	10,000	10,000	17,666	7,666
Licenses and Permits	30,000	30,000	45,864	15,864
Intergovernmental Revenue and Grants	-	-	133,357	133,357
Charges for Services	169,000	169,000	202,020	33,020
Rents and Royalties	750	750	1,160	410
Contributions & Donations from Private Sources	8,500	8,500	13,585	5,085
Other Revenue	900	900	5,802	4,902
Total Revenues	1,242,950	1,242,950	1,422,276	179,326
EXPENDITURES:				
Current:				
General Government	532,148	532,148	1,020,260	(488,112)
Public Safety	533,032	533,032	417,917	115,115
Public Works	-	-	4,676	(4,676)
Sanitation	113,420	113,420	98,918	14,502
Culture and Recreation	70,950	70,950	90,784	(19,834)
Debt Service:				
Other Debt Principal	30,000	30,000	22,851	7,149
Other Debt Interest	-	-	1,604	(1,604)
Total Expenditures	1,279,550	1,279,550	1,657,010	(377,460)
Excess (Deficiency) of Revenues Over (Under) Expenditures	(36,600)	(36,600)	(234,734)	(198,134)
OTHER FINANCING SOURCES (USES):				
Transfers In	-	-	313,242	313,242
Transfers Out (Use)	-	-	(226,766)	(226,766)
Total Other Financing Sources (Uses)	-	-	86,476	86,476
Net Change	(36,600)	(36,600)	(148,258)	(111,658)
Fund Balance - October 1 (Beginning)	192,291	192,291	192,291	-
Prior Period Adjustment	-	-	(69,645)	(69,645)
Fund Balance - September 30 (Ending)	\$ 155,691	\$ 155,691	\$ (25,612)	\$ (181,303)

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Reyna & Garza, PLLC

Certified Public Accountants

2111 Jackson Creek Ave.

Edinburg, TX 78539

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 Commission
City of Peñitas, Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Peñitas, Texas, as of and for the year ended September 30, 2012, which collectively comprise the City of Peñitas, Texas' basic financial statements and have issued our report thereon dated June 24, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of City of Peñitas, Texas is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered City of Peñitas, Texas' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of City of Peñitas, Texas' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Peñitas, Texas' internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect 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.

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

consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting. This is listed as item #2012-1. 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.

Compliance and Other Matters

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

City of Peñitas, Texas' response to the finding(s) identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit City of Peñitas, Texas response and, accordingly, we express no opinion on it.

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



Reyna & Garza, PLLC
Certified Public Accountants

June 24, 2013

Reyna & Garza, PLLC
Certified Public Accountants
2111 Jackson Creek Ave.
Edinburg, TX 78539

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS THAT
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the City Commission
City of Peñitas, Texas

Compliance

We have audited City of City of Peñitas, Texas' compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of City of Peñitas, Texas' major federal programs for the year ended September 30, 2012. City of Peñitas, Texas' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of City of Peñitas, Texas' management. Our responsibility is to express an opinion on City of Peñitas, Texas' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about City of Peñitas, Texas' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of City of Peñitas, Texas' compliance with those requirements.

In our opinion, City of Peñitas, Texas complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012.

Internal Control over Compliance

Management of City of Peñitas, Texas is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered City of Peñitas, Texas' internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over

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

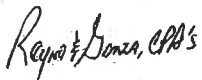
Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item #2012-2 to be a significant deficiency.

City of Peñitas, Texas' response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit City of Peñitas, Texas' response and, accordingly, we express no opinion on the response.

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



Reyna & Garza, PLLC
Certified Public Accountants

June 24, 2013

CITY OF PEÑITAS, TEXAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ending September 30, 2012

1) SUMMARY OF AUDIT RESULTS

Financial Statement Audit:

- a) The auditor's report expresses an unqualified opinion on General Purpose Financial Statements.
- b) One significant deficiency disclosed during the audit of the general purpose financial statements. It was not considered a material weakness. Refer to finding#2012-1.
- c) No instance(s) of noncompliance material to the general-purpose financial statements of City of Peñitas, which would be required to be reported in accordance with *Government Auditing Standards*, was disclosed during the audit.

Federal Programs Audit:

- d) The report on compliance for the major Federal programs for City of Peñitas expresses an unqualified opinion on all major Federal programs.
- e) One finding under Section 510(a) of OMB Circular A-133 disclosed during the audit of the major federal and state programs. It was not considered a material weakness. Refer to finding#2012-2.
- f) The programs tested as major Federal programs included: 1) Water and Waste Disposal Systems for Rural Communities (CFDA#10.760)
- g) The threshold used for distinguishing between Type A and B programs was \$300,000.
- h) City of Peñitas did not qualify as a low-risk auditee within the context of OMB Circular A-133.

2) FINDINGS – FINANCIAL STATEMENT AUDIT

2012-1 PURCHASING:

Criteria:

A purchase order system should have controls to ensure that all purchases/disbursements are through a formal authorization process, the authorization is documented, and documentation in place includes all relevant documents to include invoice and quotes or bids, if applicable.

Condition:

The City has a purchase order system, however it was not consistently followed during the year. Also, purchases/disbursements during the year had incomplete support documentation and some lacked evidence of formal authorization.

Effect:

The audit trail related to the purchase order system/disbursements was inadequate and incomplete.

Recommendation:

The organization should review its controls and procedures to ensure that the purchase order system meet audit expectations as noted above.

Corrective Action Plan:

The organization will review its controls and procedures as recommended by the auditor. The contact is Oscar Cuellar, City Manager.

3) **FINDING AND QUESTIONED COSTS – MAJOR FEDERAL AWARDS AUDIT.**

2012-2 RECORDS MANAGEMENT:

Criteria:

An organization should have controls to ensure that all pertinent source documents related to grant programs are readily available for audit purposes(e.g. contracts, request for payments, bid tabulations, etc..).

Condition:

Several months lapsed between the time grant program items selected for audit testing were requested and actually received.

Effect:

Record management controls were not effective for the major program selected for audit testing.

Recommendation:

The organization should review its controls related to records management to ensure source documents are readily available for audit purposes. Additionally, the city should maintain these records in a centralized location for easy retrieval.

Corrective Action Plan:

The organization will review its controls and procedures as recommended by the auditor. The contact is Oscar Cuellar, City Manager.

CITY OF PEÑITAS, TEXAS
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Fiscal Year Ending September 30, 2012

1. **Finding-Purchasing Manual:**

The City does not have a formal purchasing manual

Current Status:

The City is currently working to complete a formal purchasing manual.

2. **Finding-Expenses in Excess of Budget:**

The City exceeded the budget significantly.

Current Status:

Refer to current year note disclosure regarding the same.

3. **Finding-Development Corporation Sales Tax Revenues:**

Possible violations of state statutes on the use of sales tax collected could occur.

Current Status:

The city maintained separate financial accounting records for each of its development corporations in accordance with generally accepted accounting principles during the year in order to prevent the issue cited in the prior year.

4. **Finding-USDA Grant Reserve Fund:**

The City did not maintain a reserve fund as required by the grant.

Current Status:

The City established a reserve fund as required by the grant.

CITY OF PEÑITAS, TEXAS
NOTES ON ACCOUNTING POLICIES FOR FEDERAL AWARDS
YEAR ENDED SEPTEMBER 30, 2012

- The City uses the fund types specified by the Governmental Accounting Standards Board. Special revenue funds are used to account for resources restricted to, or designated for, specific purposes. Federal and state financial assistance generally is accounted for in a Special Revenue Fund because it is restricted for specific purposes.
- The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Governmental Fund types are accounted for using a current financial resources measurement focus called the modified accrual basis of accounting. Nearly all Federal grant funds were accounted for in a Special Revenue Fund which is a Governmental Fund type. With this measurement focus, only current assets and current liabilities and the fund balance are included on the balance sheet. Operating statements of these funds present increases and decreases in net current assets.

The modified accrual basis of accounting recognizes revenues in the accounting period in which they become susceptible to accrual, i.e., both measurable and available, and expenditures in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on General Long-Term Debt, which is recognized when due, and certain compensated absences and claims and judgments, which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Usually Federal grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant. When Federal grant funds are received before related expenditures are made, they are recorded as deferred revenues.

- The period of availability for federal grant funds for the purpose of liquidation of outstanding obligations made on or before the ending date of the federal project period extends 30 days beyond the federal project period ending date, in accordance with provisions in Section H, Period of Availability of Federal Funds, Part 3, OMB Circular A-133 Compliance Statement.