

CITY OF PEÑITAS, TEXAS

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED SEPTEMBER 30, 2013

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

CITY OF PEÑITAS, TEXAS  
ANNUAL FINANCIAL REPORT  
FOR THE YEAR ENDED SEPTEMBER 30, 2013

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# Reyna & Garza, PLLC

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Certified Public Accountants

2111 Jackson Creek Ave.

Edinburg, TX 78539

## INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and City Council  
City of Peñitas, Tx

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities, the business-type activities, component units, each major fund, and the aggregate remaining fund information of the City of Peñitas (the City) as of and for the year ended September 30, 2013, 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, component units, each major fund, and the aggregate remaining fund information of the City, as of September 30, 2013, 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***

### ***New Accounting Principles***

As discussed in the notes to the financial statements, management has implemented Governmental Accounting Standards Board (GASB) statement 63 *Financial Reporting of Deferred Outflows of Resources, deferred Inflows of Resources, and Net Positions* and had elected to implement early GASB 65 *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to that matter.

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the General Fund budgetary comparison information as listed on the table of contents 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's basic financial statements. The combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. 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 not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The 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 nonmajor 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.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated September 1, 2014, on our consideration of the City's 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 the City's internal control over financial reporting and compliance.

*Reyna & Garza, PLLC*  
*Certified Public Accountants*

*September 1, 2014*

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, 2013. 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 \$ 4.3 million as a result of this year's operations, or nearly 47.3 percent.
- During the year, the City had expenses that were \$ 4.4 million less than the \$ 6.7 million generated in tax and other revenues for governmental programs (before special items).
- Total cost of all of the City's programs increased from \$ 1.82 million to \$ 2.29 million (or 25.8 percent ).
- The General Fund ended the year with a deficit fund balance of \$ 395 thousand.
- The resources available for appropriation were \$ 873 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 20) 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.

## 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 \$ 9.07 million to \$ 12.30 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 negative \$ (.258) thousand at September 30, 2013.

Table I  
CITY OF PEÑITAS, TEXAS  
NET ASSETS

	Governmental Activities 2013	Governmental Activities 2012	Business-type Activities 2013	Business-type Activities 2012	Total 2013	Total 2012
Current and other assets	\$ 2,407,712	\$ 1,465,514	\$ 23,147	\$ -	\$ 2,430,859	\$ 1,465,514
Capital assets	15,267,695	12,547,933	4,135,285	-	19,402,980	12,547,933
Total assets	\$ 17,675,407	\$ 14,013,447	\$ 4,158,432	\$ -	\$ 21,833,839	\$ 14,013,447
Long-term liabilities	3,323,713	4,098,951	2,969,000	-	6,292,713	4,098,951
Other liabilities	2,050,586	841,913	-	-	2,050,586	841,913
Total liabilities	\$5,374,299	\$ 4,940,864	\$ 2,969,000	\$ -	\$ 8,343,299	\$ 4,940,864

Net Assets:						
Invested in capital assets net of related debt	\$11,943,982	\$ 8,448,982	\$ 1,189,432	\$ -	\$13,133,414	\$ 8,448,982
Restricted	615,980	502,319	-	-	615,980	502,319
Unrestricted	(258,854)	121,282	-	-	(258,854)	121,282
Total net assets	\$ 12,301,107	\$ 9,072,583	\$ 1,189,432	\$ -	\$13,490,540	\$ 9,072,583

Table II  
CITY OF PEÑITAS, TEXAS  
CHANGES IN NET ASSETS

	Governmental Activities 2013	Governmental Activities 2012	Business-type Activities 2013	Business-type Activities 2012	Total 2013	Total 2012
Revenues:						
Program Revenues:						
Charges for Services	\$ 7,500	\$ 229,810	\$ -	\$ -	\$ 7,500	\$ 229,810
General Revenues:						
Property Taxes	602,817	517,111	-	-	602,817	517,111
Sales Taxes	872,956	759,611	-	-	872,956	759,611
Franchise Taxes	126,373	118,663	-	-	126,373	118,663
Investment Earnings	16,529	-	-	-	16,529	-
Grant/Intergovernmental	4,754,853	1,832,864	-	-	4,754,853	1,832,864
Miscellaneous	274,138	70,312	-	-	274,138	70,312
Total Revenue	\$ 6,655,166	\$ 3,528,371	\$ -	\$ -	\$ 6,655,166	\$ 3,528,371
Expenses:						
General Government	\$ 992,683	\$ 780,180	-	-	\$ 992,683	\$ 780,180
Judicial	-	10,854	-	-	-	10,854
Public Safety	907,642	640,481	-	-	907,642	640,481
Public Works	-	4,676	-	-	-	4,676
Highways and Streets	161,581	107,498	-	-	161,581	107,498
Culture and Recreation	151,451	98,438	-	-	151,451	98,438
Libraries	-	-	-	-	-	-
Conservation & Development	-	-	-	-	-	-
Economic Development	54,270	222	-	-	54,270	222
Bond Interest & Cap Outlay	18,119	175,884	-	-	18,119	175,884
Utility Fund	-	-	-	-	-	-
Total Expenses	\$ 2,285,746	\$ 1,818,233	\$ -	\$ -	\$ 2,285,746	\$ 1,818,233
Increase in net assets before transfers and special items	4,369,420	1,710,138	-	-	4,369,420	1,710,138
Transfers	-	-	-	-	-	-
Special Items – Resources/Uses	(1,224,475)	-	1,189,432	-	(35,043)	-
Special Items-Prior Period Adjustments	83,580	(69,645)	-	-	83,580	(69,645)
Net assets at 10/1	\$ 9,072,583	\$ 7,432,090	\$ -	\$ -	\$ 9,072,583	\$ 7,432,090
Net assets at 9/30	\$ 12,301,108	\$ 9,072,583	\$ 1,189,432	\$ -	\$ 13,490,540	\$ 9,072,583

The cost of all governmental activities this year was \$ 2.29 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 \$ 602 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 \$ 241 thousand, which is less than last year's total of \$ 580 thousand.

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

The City's General Fund balance of negative \$ 395 thousand reported on page 11 differs from the General Fund's budgetary fund balance of negative \$ 25 thousand reported in the General Fund budgetary comparison schedule on page 33. This is principally due to revenues realized falling short of budgetary amounts.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### Capital Assets

At the end of the 2012-13 year, the City had \$12.55 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 \$ 7.04 million in construction in progress related to water and waste water improvements.

### Debt

At year-end, the City had \$ 6.3 million in bonds, capital leases, and notes outstanding versus \$4.1 million last year, an increase of 54 percent. This is due primarily to the issuance of USDA bonds in the amount of \$2.25 million in the current year.

## 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 2013/14. Amounts available for appropriation in the General Fund budget provide for no significant increase over the final 2012/13 budget of \$ 2.48 million. The City will use its revenues to finance programs we currently offered. If these estimates are realized, the City's budgetary General Fund balance is expected to remain constant by the close of 2013/14.

## 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 POSITION  
SEPTEMBER 30, 2013

EXHIBIT A-1

	Primary Government		
	Governmental Activities	Business Type Activities	Total
<b>ASSETS</b>			
Cash and Cash Equivalents	\$ 308,314	\$ 100	\$ 308,414
Investments - Current	85,004	-	85,004
Receivables (net of allowance for uncollectibles)	2,027,013	10,427	2,037,440
Internal Balances	(12,619)	12,620	1
Capital Assets:			
Land	29,305	130,000	159,305
Depreciation on Infrastructure	1,176,174	-	1,176,174
Depreciation on Buildings	513,053	-	513,053
Improvements other than Buildings, net	-	4,005,285	4,005,285
Depreciation on Furniture, Machinery and Equipment	66,206	-	66,206
Construction in Progress	13,482,957	-	13,482,957
Total Assets	<u>17,675,407</u>	<u>4,158,432</u>	<u>21,833,839</u>
<b>LIABILITIES</b>			
Accounts Payable and other current liabilities	1,792,400	-	1,792,400
Accrued Interest Payable	151,096	-	151,096
Deferred Revenues	107,090	-	107,090
Bonds Payable-Current	173,559	31,000	204,559
Noncurrent Liabilities			
Due in More Than One Year	3,150,154	2,938,000	6,088,154
Total Liabilities	<u>5,374,299</u>	<u>2,969,000</u>	<u>8,343,299</u>
<b>NET POSITION</b>			
Invested in Capital Assets, Net of Related Debt	11,943,982	1,189,432	13,133,414
Restricted for	615,980	-	615,980
Unrestricted Net Position	(258,854)	-	(258,854)
Total Net Position	<u>\$ 12,301,108</u>	<u>\$ 1,189,432</u>	<u>\$ 13,490,540</u>

The notes to the financial statements are an integral part of this statement.

CITY OF PENITAS  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Program Revenues		
Expenses	Charges for Services	Capital Grants and Contributions	
<b>Primary Government:</b>			
GOVERNMENTAL ACTIVITIES:			
General Government	\$ 992,683	\$ -	\$ -
Public Safety	907,642	7,500	-
Sanitation	161,581	-	-
Culture and Recreation	151,451	-	-
Economic Development	54,270	-	-
Debt Interest	18,119	-	-
Capital Outlay	-	-	4,639,349
Total Governmental Activities:	2,285,746	7,500	4,639,349
<b>TOTAL PRIMARY GOVERNMENT:</b>	<b>\$ 2,285,746</b>	<b>\$ 7,500</b>	<b>\$ 4,639,349</b>

General Revenues:

Taxes:

Maintenance & Operation Taxes

General Sales & Use Tax

Franchise Taxes

Penalties & Interest on Taxes

Grants and Contributions Not Restricted

Miscellaneous Revenue

Investment Earnings

Special Item - Resource & Use

Total General Revenues and Special Items

Change in Net Position

Net Position - Beginning

Prior Period Adjustment

Net Position--Ending

The notes to the financial statements are an integral part of this statement.

Net (Expense) Revenue and  
Changes in Net Position

Primary Government		
Governmental Activities	Business-type Activities	Total
\$ (992,683)	\$ -	\$ (992,683)
(900,142)	-	(900,142)
(161,581)	-	(161,581)
(151,451)	-	(151,451)
(54,270)	-	(54,270)
(18,119)	-	(18,119)
4,639,349	-	4,639,349
2,361,103	-	2,361,103
2,361,103	-	2,361,103
602,817	-	602,817
872,956	-	872,956
126,373	-	126,373
24,443	-	24,443
115,504	-	115,504
249,695	-	249,695
16,529	-	16,529
(1,224,475)	1,189,432	(35,043)
783,842	1,189,432	1,973,274
3,144,945	1,189,432	4,334,377
9,072,583	-	9,072,583
83,580	-	83,580
<u>\$ 12,301,108</u>	<u>\$ 1,189,432</u>	<u>\$ 13,490,540</u>

CITY OF PENITAS  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
SEPTEMBER 30, 2013

	General Fund	Major Sp. Rev Penitas EDC-4A Fund	Major Sp. Rev USDA Project Fund
<b>ASSETS</b>			
Cash and Cash Equivalents	\$ 36,796	\$ 28,044	\$ 132,570
Investments - Current	75,398	9,606	-
Taxes Receivable	191,691	17,040	-
Allowance for Uncollectible Taxes (credit)	(8,021)	-	-
Receivables (Net)	195,148	-	1,580,321
Due from Other Funds	18,023	423,080	-
Total Assets	<u>\$ 509,035</u>	<u>\$ 477,770</u>	<u>\$ 1,712,891</u>
<b>LIABILITIES</b>			
Accounts Payable	\$ 8,829	\$ -	\$ -
Wages and Salaries Payable	70,680	-	-
Contracts Payable	-	-	1,110,222
Retainage Payable	-	-	602,669
Due to Other Funds	456,004	238,816	-
Accrued Interest Payable	146,559	4,537	-
Unavailable Revenues	107,090	-	-
Total Liabilities	<u>789,162</u>	<u>243,353</u>	<u>1,712,891</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>			
Unavailable Revenue - Property Taxes	115,498	-	-
Total Deferred Inflows of Resources	<u>115,498</u>	<u>-</u>	<u>-</u>
<b>FUND BALANCES</b>			
Federal or State Funds Grant Restriction	-	234,417	-
Other Assigned Fund Balance	-	-	-
Unassigned Fund Balance	(395,625)	-	-
Total Fund Balances	<u>(395,625)</u>	<u>234,417</u>	<u>-</u>
Total Liabilities, Deferred Inflows & Fund Balances	<u>\$ 509,035</u>	<u>\$ 477,770</u>	<u>\$ 1,712,891</u>

The notes to the financial statements are an integral part of this statement.

Other Funds	Total Governmental Funds
\$ 110,904	\$ 308,314
-	85,004
50,834	259,565
-	(8,021)
-	1,775,469
253,154	694,257
<u>\$ 414,892</u>	<u>\$ 3,114,588</u>
\$ -	\$ 8,829
-	70,680
-	1,110,222
-	602,669
12,056	706,876
-	151,096
-	107,090
<u>12,056</u>	<u>2,757,462</u>
-	115,498
-	115,498
381,563	615,980
21,273	21,273
-	(395,625)
<u>402,836</u>	<u>241,628</u>
<u>\$ 414,892</u>	<u>\$ 3,114,588</u>

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CITY OF PENITAS  
 RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE  
 STATEMENT OF NET POSITION  
 SEPTEMBER 30, 2013

<b>Total Fund Balances - Governmental Funds</b>	\$	241,628
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 \$13,608,690 and the accumulated depreciation was \$1,060,757. 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 position.		8,448,982
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 2013 capital outlays and debt principal payments is to increase (decrease) net position.		7,106,505
The 2013 depreciation expense increases accumulated depreciation. The net effect of the current year's depreciation is to decrease net position.		(137,030)
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 position.		(1,108,977)
Record new USDA debt		(2,250,000)
<b>Net Position of Governmental Activities</b>	<b>\$</b>	<b>12,301,108</b>

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, 2013

	General Fund	Major Sp. Rev Penitas EDC-4A Fund	Major Sp. Rev USDA Project Fund
<b>REVENUES:</b>			
Taxes:			
Property Taxes	\$ 635,171	\$ -	\$ -
General Sales and Use Taxes	437,440	109,197	-
Franchise Tax	126,373	-	-
Penalty and Interest on Taxes	24,443	-	-
Licenses and Permits	53,307	-	-
Intergovernmental Revenue and Grants	92,766	-	4,639,349
Charges for Services	-	-	-
Fines	196,388	-	-
Rents and Royalties	1,261	-	-
Contributions & Donations from Private Sources	22,738	-	-
Other Revenue	14,205	68	-
Total Revenues	<u>1,604,092</u>	<u>109,265</u>	<u>4,639,349</u>
<b>EXPENDITURES:</b>			
Current:			
General Government	931,408	-	87
Public Safety	682,825	-	-
Public Works:			
Sanitation	151,989	-	-
Culture and Recreation	142,544	-	-
Conservation and Development:			
Economic Development and Assistance	-	46,734	-
Debt Service:			
Other Debt Principal	-	54,152	-
Other Debt Interest	1	18,118	-
Capital Outlay:			
Capital Outlay	-	-	7,038,180
Total Expenditures	<u>1,908,767</u>	<u>119,004</u>	<u>7,038,267</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(304,675)</u>	<u>(9,739)</u>	<u>(2,398,918)</u>
<b>OTHER FINANCING SOURCES (USES):</b>			
Non-Current Loans	-	-	2,250,000
Transfers In	18,308	-	167,226
Transfers Out (Use)	(167,226)	-	(18,308)
Total Other Financing Sources (Uses)	<u>(148,918)</u>	<u>-</u>	<u>2,398,918</u>
Net Change in Fund Balances	(453,593)	(9,739)	-
Fund Balance - October 1 (Beginning)	(25,612)	244,156	-
Prior Period Adjustment	83,580	-	-
Fund Balance - September 30 (Ending)	<u>\$ (395,625)</u>	<u>\$ 234,417</u>	<u>\$ -</u>

The notes to the financial statements are an integral part of this statement.

Other Funds	Total Governmental Funds
\$ -	\$ 635,171
326,319	872,956
-	126,373
-	24,443
-	53,307
-	4,732,115
7,500	7,500
-	196,388
-	1,261
-	22,738
995	15,268
<u>334,814</u>	<u>6,687,520</u>
-	931,495
171,375	854,200
-	151,989
-	142,544
-	46,734
-	54,152
-	18,119
<u>17,808</u>	<u>7,055,988</u>
<u>189,183</u>	<u>9,255,221</u>
<u>145,631</u>	<u>(2,567,701)</u>
-	2,250,000
-	185,534
-	(185,534)
-	2,250,000
145,631	(317,701)
257,205	475,749
-	83,580
<u>\$ 402,836</u>	<u>\$ 241,628</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, 2013

<b>Total Net Change in Fund Balances - Governmental Funds</b>	\$	(317,701)
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 2013 capital outlays and debt principal payments is to increase (decrease) the change in net position.		7,106,505
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 the change in net position.		(137,030)
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) the change in net position.		(1,256,829)
New USDA debt		(2,250,000)
<b>Change in Net Position of Governmental Activities</b>	<b>\$</b>	<b>3,144,945</b>

The notes to the financial statements are an integral part of this statement.

CITY OF PENITAS  
STATEMENT OF NET POSITION  
PROPRIETARY FUNDS  
SEPTEMBER 30, 2013

	Business Type Activities
<hr/>	
ASSETS	
<b>Current Assets:</b>	
Cash and Cash Equivalents	\$ 100
Accounts Receivable-Net of Uncollectible Allowance	10,427
Due from Other Funds	12,620
Total Current Assets	23,147
<b>Noncurrent Assets:</b>	
Capital Assets:	
Land Purchase and Improvements	130,000
Improvements other than Buildings	4,063,475
Accumulated Depreciation - Other Improvements	(58,190)
Total Noncurrent Assets	4,135,285
Total Assets	4,158,432
LIABILITIES	
<b>Current Liabilities:</b>	
Notes Payable - Current	31,000
Total Current Liabilities	31,000
<b>NonCurrent Liabilities:</b>	
Notes Payable - Noncurrent	2,938,000
Total Noncurrent Liabilities	2,938,000
Total Liabilities	2,969,000
NET POSITION	
Net Investment in Capital Assets	1,189,432
Total Net Position	\$ 1,189,432

The notes to the financial statements are an integral part of this statement.

CITY OF PENITAS  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Business Type Activities
Capital Contributions	\$ 1,189,432
Change in Net Position	1,189,432
Total Net Position -October 1 (Beginning)	-
 Total Net Position September 30 (Ending)	 \$ 1,189,432

The notes to the financial statements are an integral part of this statement.

CITY OF PENITAS  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Business Type Activities
<hr/>	
<u>Cash Flows from Operating Activities:</u>	
Cash Payments related to Fund Transfers	\$ (23,047)
<u>Cash Flows from Capital &amp; Related Financing Activities:</u>	
Acquisition of Capital Assets	(4,135,285)
Capital Contributed by Other Funds	1,189,432
Long Term Debt issued	2,969,000
Net Cash Provided by Capital and Related Financing Activities	23,147
Net Increase in Cash and Cash Equivalents	100
Cash and Cash Equivalents at Beginning of the Year:	-
Cash and Cash Equivalents at the End of the Year:	\$ 100
<u>Reconciliation of Operating Income (Loss) to Net Cash     Provided By (Used For) Operating Activities:</u>	
Operating Income (Loss):	\$ -
Effect of Increases and Decreases in Current Assets and Liabilities:	
Decrease (increase) in Receivables	(10,427)
Decrease (increase) in Due From Other Funds	(12,620)
Net Cash Provided by (Used for) Operating Activities	\$ (23,047)

The notes to the financial statements are an integral part of this statement.

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CITY OF PEÑITAS, TX

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED SEPTEMBER 30, 2013

**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.

On October 1, 2012, the District adopted GASB Statement No. 63 *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and early implemented GASB Statement No. 65 *Items Previously Reported As Assets and Liabilities* as encouraged by GASB. As a result of the adoption of these new accounting standards, a restatement of beginning net position at the government-wide level financial statements was required.

GASB Statement No. 63 provides financial guidance for reporting deferred outflows, deferred inflows of resources, and net position in a statement of financial position and related disclosures. Deferred outflows of resources are defined as a consumption of net assets by a government that is applicable to a future reporting period and deferred inflows of resources are defined as an acquisition of net assets by a government that is applicable to a future reporting period. Net position is defined as the residual of all other elements presented in a statement of financial position, being measured as the difference between (a) assets and deferred resources and (b) liabilities and deferred inflows of resources.

GASB Statement No. 65 establishes accounting and financial reporting that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term "deferred" in financial statement presentations.

#### **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.

The City reports the following major enterprise fund(s):

1. **The Public Utilities Department** – This fund’s function is to provide for a source of supply of water, its purification and distribution to customers and to collect and treat wastewater for municipal customers and administer a private franchised solid waste collection and transportation service.

Additionally, the City reports the following fund type(s):

1. **Capital Projects Fund** – This fund is a capital projects fund. It is used to account for the proceeds from long-term debt financing and revenues and expenditures related to authorized construction and other capital asset acquisitions.
2. **Debt Service Funds** – The City accounts for resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds in a debt service fund.

#### 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 from 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 Year</u>	<u>Change in Net</u> <u>Assets</u>
Land	\$ 159,305	\$ 0	\$ 159,305	
Buildings	1,043,643	(490,545)	553,098	
Furniture & Equipment	356,585	(253,704)	102,881	
Infrastructure	1,540,992	(316,508)	1,224,484	
Construction in Progress	<u>10,508,165</u>	<u>0</u>	<u>10,508,165</u>	
Change in Net Assets				<u>\$ 12,547,933</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			\$ -	
Notes Payable			669,951	
Certificates of Obligation			<u>3,429,000</u>	
Change in Net Assets				<u>\$ (4,098,951)</u>
Net Adjustment to Net Assets				<u>\$ 8,448,982</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 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</u> <u>Changes in Net Assets</u>	<u>Adjustments to Net</u> <u>Assets</u>
<u>Current Year Capital Outlay</u>			
Various Categories	<u>\$ 7,050,267</u>	<u>\$ 7,050,267</u>	<u>\$ 7,050,267</u>
Total Capital Outlay	<u>\$ 7,050,267</u>	<u>\$ 7,050,267</u>	<u>\$ 7,050,267</u>
<u>Debt Principal Payments</u>			
Loan Principal	\$ 56,238	\$ 56,238	\$ 56,238
Capital Lease Principal	-	-	-
Total Principal Payments	<u>\$ 56,238</u>	<u>\$ 56,238</u>	<u>\$ 56,238</u>
Total Adjustment to Net Assets		<u>\$ 7,106,505</u>	<u>\$ 7,106,505</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>			
Uncollected taxes(assumed collectible) from Current Year Levy	\$ 115,498	\$ 115,498	\$ (32,354)
Fixed assets transferred to Utility Fund		(4,193,475)	(4,193,475)
Long term debt transferred Utility Fund		<u>2,969,000</u>	<u>2,969,000</u>
Total		<u>\$ (1,108,977)</u>	<u>\$ (1,256,829)</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 2013.
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>
Public Safety	\$ 65,175
Sanitation	\$ 34,439
Culture and Recreation	\$ 32,344

**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, 2013, the carrying amount of the City's deposits (cash and interest-bearing savings accounts included in temporary investments) was \$ 308,414 and the bank balance was \$ 285,115. The City's cash deposits at September 30, 2013 and during the year ended September 30, 2013 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, 2013, the City had the following investments;

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>			<u>More Than 10</u>
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	
<u>General Fund:</u>					
Certificate of Deposit	\$ 75,398	\$ 75,398			
Total-General Fund	\$ 75,398	\$ 75,398			
<u>Special Revenues Funds:</u>					
Certificate of Deposit	\$ 9,606	\$ 9,606			
Total-Special Revenue Fund	\$ 9,606	\$ 9,606			
Subtotal-Governmental Type	\$ 85,004	\$ 85,004			
Total-All Fund Types	\$ 85,004	\$ 85,004			

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, 2013, 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, 2013 consisted of the following:

Due From Fund	Due To Fund	Amount	Purpose
General Fund	Special Revenue Funds	\$ 442,641	Short-term loans
General Fund	Enterprise Fund	12,620	Short-term loans
Special Revenue Funds	Special Revenue Funds	246,392	Short-term loans
Special Revenue Funds	General Fund	<u>5,223</u>	Short-term loans
	Total	<u>\$ 706,876</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, 2013 consisted of the following:

Transfers From	Transfers To	Amount	Reason
General Fund	USDA Project	\$167,226	Supplemental other funds sources
USDA Project	General Fund	18,308	Supplemental other funds sources
	Total	<u>\$185,534</u>	

## E. CAPITAL ASSET ACTIVITY

Capital asset activity for the City for the year ended September 30, 2013, was as follows:

	Primary Government			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements &amp; Adjustments</u>	<u>Ending Balance</u>
Governmental Activities:				
Land	\$ 159,305	\$ -	\$ (130,000)	\$ 29,305
Buildings	1,043,643	-	-	1,043,643
Furniture and Equipment	356,585	12,000	-	368,585
Infrastructure	1,540,992	-	-	1,540,992
Construction in Progress	<u>10,508,165</u>	<u>7,038,267</u>	<u>(4,063,475)</u>	<u>13,482,957</u>
Totals at Historic Cost	<u>\$ 13,608,690</u>	<u>\$ 1,787,023</u>	<u>\$ (4,193,475)</u>	<u>\$ 16,465,482</u>
Less Accumulated Depreciation:				
Total Accumulated Depreciation	<u>(1,060,757)</u>	<u>(137,030)</u>	<u>(-)</u>	<u>(1,197,787)</u>
Governmental Activities Capital Assets, Net	<u>\$ 12,547,933</u>	<u>\$ 1,627,365</u>	<u>\$ (-)</u>	<u>\$ 15,267,695</u>

Depreciation expense was charged to governmental functions as follows:

General Government	\$ 57,553
Public Safety	53,442
Sanitation/Public Works	9,592
Economic Development	7,536
Culture & Recreation	<u>8,907</u>
Total Depreciation Expense	<u>\$ 137,030</u>

## F. BONDS AND OTHER LONG-TERM PAYABLES

At September 30, 2013, long-term debt consisted of the following:

General Long Term Debt:

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
Loan Certificate of Obligation from USDA 92-06 for \$2,250,000, with annual interest rate of 3.00%; due date on November 1, 2050.	<u>2,250,000</u>
General Long Term Debt (continued):	
Subtotal-Bonds Payable	\$ 2,710,000

### Notes Payable:

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	57,575
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	<u>481,138</u>

Subtotal-Notes Payable \$ 613,713

Total General Long Term Debt \$ 3,323,713

Proprietary Fund Type:

Bonds:

\$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

Subtotal-Bonds Payable \$ 2,969,000

Total Long-Term Debt \$ 6,292,713

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, 2013.

**G. DEBT SERVICE REQUIREMENTS**

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

Year Ending	Govt. Fund Type Notes Payable		Govt. Fund Type Certificates of Obligation		Proprietary Type Certificates of Obligation		All Debt	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
30-Sep								
2014	\$167,559	\$21,098	\$6,000	\$74,265	\$31,000	\$123,375	\$204,559	\$218,738
2015	36,755	13,834	38,000	77,830	33,000	122,093	107,755	213,757
2016	33,705	12,733	39,000	76,733	34,000	120,728	106,705	210,194
2017	34,817	11,621	40,000	75,590	36,000	119,318	110,817	206,529
2018	35,966	10,472	42,000	74,418	38,000	117,825	115,966	202,715
2019- 2023	198,429	33,761	227,000	353,026	211,000	564,526	636,429	951,313
2024- 2028	106,482	4,142	264,000	317,687	266,000	516,414	636,482	838,243
2029- 2033	-	-	305,000	276,603	329,000	456,248	634,000	732,851
2034- 2038	-	-	354,000	229,183	409,000	381,601	763,000	610,784
2039- 2043	-	-	411,000	174,056	506,000	288,960	917,000	463,016
2044- 2048	-	-	478,000	109,991	628,000	173,888	1,106,000	283,879
2049- 2053	-	-	506,000	36,156	448,000	37,846	954,000	74,002
Total	<u>\$613,713</u>	<u>\$107,661</u>	<u>\$2,710,000</u>	<u>\$1,875,538</u>	<u>\$2,969,000</u>	<u>\$3,022,822</u>	<u>\$6,292,713</u>	<u>\$5,006,021</u>

**H. CHANGES IN LONG-TERM LIABILITIES**

Long-term activity for the year ended September 30, 2013, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<b>Governmental Type Activities:</b>					
Bonds and Notes Payable:					
Capital Leases	-	\$ -	\$ -	\$ -	\$ -
Certificates of Obligation	3,429,000	2,250,000	(2,969,000)	2,710,000	6,000
Notes Payable	<u>669,951</u>	<u>-</u>	<u>(56,238)</u>	<u>613,713</u>	<u>167,559</u>
Total Bonds and Notes Payable	<u>\$ 4,098,951</u>	<u>\$ 2,250,000</u>	<u>\$ (3,025,238)</u>	<u>\$ 3,323,713</u>	<u>\$173,559</u>
<b>Proprietary Type Activities:</b>					
Bonds and Notes Payable:					
Certificates of Obligation	\$ -	<u>2,969,000</u>	-	<u>\$ 2,969,000</u>	<u>31,000</u>
Total Bonds Payable	<u>\$ -</u>	<u>\$ 2,969,000</u>	<u>\$ -</u>	<u>\$ 2,969,000</u>	<u>31,000</u>
Total Proprietary Activities Long-term Liabilities	<u>\$ -</u>	<u>\$ 2,969,000</u>	<u>\$ -</u>	<u>\$2,969,000</u>	<u>\$ 31,000</u>
 Total-All Activities Long-term Liabilities	 <u>\$ 4,098,951</u>	 <u>\$ 5,219,000</u>	 <u>\$ (3,025,238)</u>	 <u>\$ 6,292,713</u>	 <u>\$ 204,559</u>

**I. DEFERRED REVENUE( UNAVAILABLE REVENUES)**

Deferred revenue at year-end consisted of the following:

	<u>Governmental Funds</u>	<u>Total</u>
Deferred Revenue	<u>\$107,090</u>	<u>\$107,090</u>
Total Deferred Revenue	<u>\$107,090</u>	<u>\$107,090</u>

Net uncollected warrant revenues in the general fund represents the entire amount of the total amount reflected as deferred revenues(unavailable 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, 2013 was (\$ 395,625).

**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 2013, 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, 2013 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, 2013 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 increased by \$83,580. The City's General Fund fund balance also increased by \$83,580 both due to the recognition of an addition liability due to the Texas Comptroller.

#### **P. SUBSEQUENT EVENTS**

The City considered items and events through September 1, 2014.

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CITY OF PENITAS  
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE  
BUDGET AND ACTUAL - GENERAL FUND  
FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Budgeted Amounts		Actual Amounts (GAAP BASIS)	Variance With Final Budget Positive or (Negative)
	Original	Final		
<b>REVENUES:</b>				
Taxes:				
Property Taxes	\$ 727,500	\$ 711,600	\$ 635,171	\$ (76,429)
General Sales and Use Taxes	770,000	580,000	437,440	(142,560)
Franchise Tax	96,800	111,700	126,373	14,673
Penalty and Interest on Taxes	-	-	24,443	24,443
Licenses and Permits	34,500	48,500	53,307	4,807
Intergovernmental Revenue and Grants	472,900	436,650	92,766	(343,884)
Charges for Services	182,700	180,500	-	(180,500)
Fines	-	-	196,388	196,388
Investment Earnings	200	200	-	(200)
Rents and Royalties	-	-	1,261	1,261
Contributions & Donations from Private Sources	-	-	22,738	22,738
Other Revenue	3,500	408,400	14,205	(394,195)
Total Revenues	2,288,100	2,477,550	1,604,092	(873,458)
<b>EXPENDITURES:</b>				
Current:				
General Government	880,890	1,013,250	931,408	81,842
Public Safety	610,360	617,650	682,825	(65,175)
Public Works:				
Sanitation	130,350	117,550	151,989	(34,439)
Culture and Recreation	107,600	110,200	142,544	(32,344)
Conservation and Development	277,000	277,000	-	277,000
Debt Service:				
Other Debt Interest	-	60,000	1	59,999
Capital Outlay:				
Capital Outlay	281,900	281,900	-	281,900
Total Expenditures	2,288,100	2,477,550	1,908,767	568,783
Excess (Deficiency) of Revenues Over (Under) Expenditures	-	-	(304,675)	(304,675)
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers In	-	-	18,308	18,308
Transfers Out (Use)	-	-	(167,226)	(167,226)
Total Other Financing Sources (Uses)	-	-	(148,918)	(148,918)
Net Change	-	-	(453,593)	(453,593)
Fund Balance - October 1 (Beginning)	(25,612)	(25,612)	(25,612)	-
Prior Period Adjustment	-	-	83,580	83,580
Fund Balance - September 30 (Ending)	\$ (25,612)	\$ (25,612)	\$ (395,625)	\$ (370,013)

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CITY OF PENITAS  
 COMBINING BALANCE SHEET  
 NONMAJOR GOVERNMENTAL FUNDS  
 SEPTEMBER 30, 2013

	Crime Control & Prevention District	Police Department Asset Forfeit	Penitas EDC-4B Fund	Total Nonmajor Governmental Funds
<b>ASSETS</b>				
Cash and Cash Equivalents	\$ 97,136	\$ 13,768	\$ -	\$ 110,904
Taxes Receivable	33,797	-	17,037	50,834
Due from Other Funds	-	19,561	233,593	253,154
Total Assets	<u>\$ 130,933</u>	<u>\$ 33,329</u>	<u>\$ 250,630</u>	<u>\$ 414,892</u>
<b>LIABILITIES</b>				
Due to Other Funds	\$ -	\$ 12,056	\$ -	\$ 12,056
Total Liabilities	<u>-</u>	<u>12,056</u>	<u>-</u>	<u>12,056</u>
<b>FUND BALANCES</b>				
Federal or State Funds Grant Restriction	130,933	-	250,630	381,563
Other Assigned Fund Balance	-	21,273	-	21,273
Total Fund Balances	<u>130,933</u>	<u>21,273</u>	<u>250,630</u>	<u>402,836</u>
Total Liabilities and Fund Balances	<u>\$ 130,933</u>	<u>\$ 33,329</u>	<u>\$ 250,630</u>	<u>\$ 414,892</u>

The notes to the financial statements are an integral part of this statement.

CITY OF PENITAS  
 COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN  
 FUND BALANCES - NONMAJOR GOVERNMENTAL FUNDS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2013

	Crime Control & Prevention District	Police Department Asset Forfeit	Penitas EDC-4B Fund	Total Nonmajor Governmental Funds
<b>REVENUES:</b>				
Taxes:				
General Sales and Use Taxes	\$ 217,123	\$ -	\$ 109,196	\$ 326,319
Charges for Services	-	7,500	-	7,500
Other Revenue	995	-	-	995
Total Revenues	<u>218,118</u>	<u>7,500</u>	<u>109,196</u>	<u>334,814</u>
<b>EXPENDITURES:</b>				
Current:				
Public Safety	170,284	1,091	-	171,375
Capital Outlay:				
Capital Outlay	-	17,808	-	17,808
Total Expenditures	<u>170,284</u>	<u>18,899</u>	<u>-</u>	<u>189,183</u>
Net Change in Fund Balance	47,834	(11,399)	109,196	145,631
Fund Balance - October 1 (Beginning)	<u>83,099</u>	<u>32,672</u>	<u>141,434</u>	<u>257,205</u>
Fund Balance - September 30 (Ending)	<u>\$ 130,933</u>	<u>\$ 21,273</u>	<u>\$ 250,630</u>	<u>\$ 402,836</u>

The notes to the financial statements are an integral part of this statement.

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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 *GOVERNMENTAL AUDITING  
STANDARDS***

Independent Auditor's Report

To the Honorable Mayor and City Council  
City of Peñitas, Tx

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, component units, each major fund, and the aggregate remaining fund information of the City of Peñitas, as of and for the year ended September 30, 2013, and the related notes to the financial statements, which collectively comprise the City of Peñitas' basic financial statements, and have issued our report thereon dated September 1, 2014.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered City of Peñitas' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of City of Peñitas' internal control. Accordingly, we do not express an opinion on the effectiveness of City of Peñitas' 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. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be a significant deficiency as item #2013-1.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether City of Peñitas' 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*.

**Response to Findings**

City of Peñitas' response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. City of Peñitas' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**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.

*Reyna & Garza, PLLC*  
*Certified Public Accountants*

*September 1, 2014*

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# Reyna & Garza, PLLC

Certified Public Accountants

2111 Jackson Creek Ave.

Edinburg, TX 78539

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

Honorable Mayor and City Council  
City of Peñitas, Tx

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

We have audited City of Peñitas' 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' major federal programs for the year ended September 30, 2013. City of Peñitas' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

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

***Auditor's Responsibility***

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

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

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

In our opinion, City of Peñitas, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2013.

## **Report on Internal Control Over Compliance**

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

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

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

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

*Reyna & Garza, PLLC*  
*Certified Public Accountants*

*September 1, 2014*

CITY OF PEÑITAS, TEXAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ending September 30, 2013

1) **SUMMARY OF AUDIT RESULTS**

**Financial Statement Audit:**

- a) The auditor's report expresses an unqualified opinion on General Purpose Financial Statements.
- b) Significant deficiency disclosed during the audit of the general purpose financial statements. It was not considered material weakness. Refer to finding#2013-1.
- 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) No finding under Section 510(a) of OMB Circular A-133 disclosed during the audit of the major federal programs.
- 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**

**2013-1 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.**

None Noted

CITY OF PEÑITAS, TEXAS  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
Fiscal Year Ending September 30, 2013

1. **Purchasing:**

The City has a purchasing system in place, 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.

**Current Status:**

Refer to current year findings.

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CITY OF PEÑITAS  
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
 YEAR ENDED SEPTEMBER 30, 2013

G-1

DESCRIPTION	FEDERAL CFDA NUMBER	GRANTOR NUMBER	EXPENDITURES/ DISBURSEMENTS
<u>U.S. DEPARTMENT OF AGRICULTURE</u>			
Water & Waste Disposal Systems For Rural Communities	10.76	50-008-742676783	<u>7,038,180</u>
<u>TOTAL-US DEPARTMENT OF AGRICULTURE</u>			<u>7,038,180</u>
TOTAL FEDERAL AWARDS			<u><u>7,038,180</u></u>

CITY OF PEÑITAS, TEXAS  
NOTES ON ACCOUNTING POLICIES FOR FEDERAL AWARDS  
YEAR ENDED SEPTEMBER 30, 2013

- 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.