



CITY OF SHOREACRES, TEXAS

ANNUAL FINANCIAL REPORT

**FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2011**

CITY OF SHOREACRES, TEXAS

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FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Members of the City Council
City of Shoreacres, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund, of the City of Shoreacres, Texas as of and for the year ended September 30, 2011, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Shoreacres, Texas' management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the City of Shoreacres, Texas as of September 30, 2011, and the respective changes in financial position, and where applicable, cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 20, 2012, on our consideration of the City of Shoreacres, Texas' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 30 through 31 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.

Pattillo, Brown + Hill, L.L.P.

April 20, 2012

Management's Discussion and Analysis

As management of the City of Shoreacres, we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended September 30, 2011.

FINANCIAL HIGHLIGHTS

- The assets of the City of Shoreacres exceeded its liabilities as of September 30, 2011, by \$3,128,670 (net assets). Unrestricted net assets of the City, however, were \$2,111,209 as of September 30, 2011. Unrestricted net assets represent those assets that may be used to meet the City's ongoing obligations to citizens and creditors in accordance with the City's fund designation and fiscal policies.
- The City's total net assets decreased by \$(9,708) from 2010.
- As of the close of the current fiscal year, the City of Shoreacres' governmental fund reported an ending fund balance of \$1,536,043. The unassigned portion of the fund was \$1,536,043.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements and (3) notes to the financial statements.

Government-wide financial statements – The government-wide financial statements, which begin on page 9 of this report, are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

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

The Statement of Activities presents information showing how the City's net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods (e.g., uncollected taxes and earned but unused compensated absences).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include General Government, Municipal Court, Public Safety, Public Works, Highways and Streets and Culture and Recreation. The business-type activities of the City include Water, Sewer and Solid Waste activities.

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

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

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

Proprietary funds – The City maintains one type of proprietary fund. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses an Enterprise Fund to account for Water, Sewer and Solid Waste operations.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The basic proprietary fund financial statements, which begin on page 15 of this report, provide information for the Water, Sewer and Solid Waste Enterprise Fund, since this is considered to be a major fund of the City.

Notes to the financial statements – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 18 – 32 of this report.

GOVERNMENTAL-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Shoreacres, assets exceeded liabilities by \$3,128,670 as of September 30, 2011.

The largest portion of the City's net assets \$1,886,627 reflects its cash and investment balances.

CITY OF SHOREACRES' NET ASSETS

	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Totals</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Current and other assets	\$ 1,673,504	\$ 1,788,150	\$ 737,655	\$ 740,012	\$ 2,411,159	\$ 2,528,162
Capital assets	<u>805,746</u>	<u>686,954</u>	<u>211,715</u>	<u>154,184</u>	<u>1,017,461</u>	<u>841,138</u>
Total assets	<u>2,479,250</u>	<u>2,475,104</u>	<u>949,370</u>	<u>894,196</u>	<u>3,428,620</u>	<u>3,369,300</u>
Long-term liabilities	69,475	59,079	2,268	5,384	71,743	64,463
Other liabilities	<u>109,373</u>	<u>83,014</u>	<u>118,834</u>	<u>83,445</u>	<u>228,207</u>	<u>166,459</u>
Total liabilities	<u>178,848</u>	<u>142,093</u>	<u>121,102</u>	<u>88,829</u>	<u>299,950</u>	<u>230,922</u>
Net assets:						
Invested in capital assets, net of related debt	805,746	686,954	211,715	154,184	1,017,461	841,138
Restricted	-	21,489	-	-	-	21,489
Unrestricted	<u>1,494,656</u>	<u>1,624,568</u>	<u>616,553</u>	<u>651,183</u>	<u>2,111,209</u>	<u>2,275,751</u>
Total net assets	\$ <u>2,300,402</u>	\$ <u>2,333,011</u>	\$ <u>828,268</u>	\$ <u>805,367</u>	\$ <u>3,128,670</u>	\$ <u>3,138,378</u>

The balance \$2,111,209 of unrestricted net assets may be used to meet the City's ongoing obligation to citizens and creditors in accordance with the City's fund designation and fiscal policies.

Analysis of the City's operations – The following table provides a summary of the City's operations for the year ended September 30, 2011.

CITY OF SHOREACRES' CHANGES IN NET ASSETS

	Governmental Activities		Business-type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Revenues:						
Program revenues:						
Charges for services	\$ 290,137	\$ 331,806	\$ 471,079	\$ 262,845	\$ 761,216	\$ 594,651
Operating grants and contributions	151,617	1,047	-	-	151,617	1,047
Capital grants and contributions	45,628	32,054	43,789	48,946	89,417	81,000
General revenues:						
Property taxes	804,855	778,017	-	-	804,855	778,017
Sales taxes	65,418	61,508	-	-	65,418	61,508
Franchise taxes	89,076	56,798	-	-	89,076	56,798
Other taxes	4,144	4,035	-	-	4,144	4,035
Investment earnings	4,932	7,686	2,617	5,515	7,549	13,201
Miscellaneous	5,992	50,060	34,247	34,082	40,239	84,142
Transfers	-	-	-	-	-	-
Total revenues and transfers	<u>1,461,799</u>	<u>1,323,011</u>	<u>551,732</u>	<u>351,388</u>	<u>2,013,531</u>	<u>1,674,399</u>
Expenses:						
General government	570,077	504,344	-	-	570,077	504,344
Public safety	515,026	455,281	-	-	515,026	455,281
Public works	134,277	177,239	-	-	134,277	177,239
Judicial	89,819	78,614	-	-	89,819	78,614
Highways and streets	107,183	100,290	-	-	107,183	100,290
Culture and recreation	78,026	42,140	-	-	78,026	42,140
Water and sewer	-	-	528,831	401,252	528,831	401,252
Total expenses	<u>1,494,408</u>	<u>1,357,908</u>	<u>528,831</u>	<u>401,252</u>	<u>2,023,239</u>	<u>1,759,160</u>
Change in net assets	(32,609)	(34,897)	22,901	(49,864)	(9,708)	(84,761)
Net assets - beginning	<u>2,333,011</u>	<u>2,367,908</u>	<u>805,367</u>	<u>855,231</u>	<u>3,138,378</u>	<u>3,223,139</u>
Net assets - ending	<u>\$ 2,300,402</u>	<u>\$ 2,333,011</u>	<u>\$ 828,268</u>	<u>\$ 805,367</u>	<u>\$ 3,128,670</u>	<u>\$ 3,138,378</u>

Governmental activities decreased net assets during the fiscal year by \$(32,609). Grant revenue and general government expenditures were much smaller due to Hurricane IKE relief receipts and efforts ending in fiscal year 2009.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

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

At the end of the current fiscal year, the City of Shoreacres’ governmental fund reported an ending fund balance of \$1,536,043 of which \$1,536,043 constitutes unassigned fund balance.

General fund budgetary highlights – The City made no revisions to the original appropriations approved by the City Council.

Refer to the General Fund Statement of Revenue, Expenditures and Changes in Fund Balances – Budget and Actual on page 33 of this report for a detailed presentation of the actual General Fund operations compared to both the original and final budget for fiscal year 2011.

Proprietary funds – The City’s proprietary fund statements beginning on page 15 of this report provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the major proprietary fund, the Water and Sewer Fund, were \$616,553. This fund experienced an increase in total net assets during 2011 of \$22,901

CAPITAL ASSETS

The City of Shoreacres’ investment in capital assets for its governmental and business-type activities as of September 30, 2011, amounts to \$1,017,461 (net of accumulated depreciation). This investment in capital assets includes land, buildings, machinery and equipment, water system, and sewer system. The significant change in Buildings and improvements is due to the General Fund’s renovations to City Hall due to damages caused by Hurricane Ike.

CITY OF SHOREACRES’ CAPITAL ASSETS AT YEAR-END

	Governmental Activities		Business-type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Land	\$ 175,164	\$ 175,164	\$ 7,839	\$ 7,839	\$ 183,003	\$ 183,003
Land improvements	-	-	19,940	19,940	19,940	19,940
Leasehold improvements	86,907	56,297	-	-	86,907	56,297
Buildings and improvements	177,629	153,379	5,000	5,000	182,629	158,379
Vehicles and Equipment	289,663	199,475	21,642	21,642	311,305	221,117
Infrastructure	255,082	255,082	24,104	-	279,186	255,082
Construction in progress	49,972	62,664	92,735	48,946	142,707	111,610
Water and wastewater distribution	-	-	300,059	300,059	300,059	300,059
Less: accumulated depreciation	(228,671)	(215,107)	(259,604)	(249,242)	(488,275)	(464,349)
Total capital assets, net	\$ 805,746	\$ 686,954	\$ 211,715	\$ 154,184	\$ 1,017,461	\$ 841,138

DEBT ADMINISTRATION

At the end of the current fiscal year, the City of Shoreacres did not have any bonded debt or notes payable.

ECONOMIC FACTS

Hurricane Ike, the third costliest hurricane ever to hit the United States, made landfall just over 30 miles from the City of Shoreacres in Galveston, Texas on September 13, 2008. Right after the hurricane, the City estimated that 575 of its 650 homes had been flooded and were uninhabitable.

Although the City suffered significant public and private damage from Hurricane Ike, it occurred after the 2009 property tax rate was established for application to values rendered in January 2008 (prior to storm damage). Accordingly, the adverse financial impact of diminished property values due to storm damage fell outside the current fiscal year. Property tax collection, which is the City's primary governmental fund revenue source, was not significantly affected.

Extraordinary expenses incurred as a direct result of Hurricane Ike were offset by federal grants and emergency assistance funds. Additionally, large capital improvement projects budgeted for the current fiscal year were deferred reducing expenditures.

Despite catastrophic public and private property damage the city has maintained all services and governmental functions in support of recovery. An accelerated building permit program has allowed rapid repair and reconstruction of damaged residential structures and commercial facilities.

REQUESTS FOR INFORMATION

The financial report is designed to provide our citizens, customers, investors and creditors with a general overview of the City's finances. If you have questions about this report or need any additional information, contact David Stall, City Administrator, at 601 Shoreacres Blvd, Shoreacres, TX 77571 or call (281) 471-2244.

CITY OF SHOREACRES, TEXAS

STATEMENT OF NET ASSETS

SEPTEMBER 30, 2011

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS			
Cash	\$ 384,440	\$ 317,431	\$ 701,871
Investments	1,184,756	-	1,184,756
Receivables (net of allowances for uncollectibles):			
Taxes	60,954	-	60,954
Accounts	73,554	130,851	204,405
Internal balances	(289,373)	289,373	-
Receivables from other governments	259,173	-	259,173
Capital assets:			
Land	175,164	7,839	183,003
Land improvements	-	19,940	19,940
Leasehold improvements	86,907	-	86,907
Buildings and improvements	177,629	5,000	182,629
Vehicles and equipment	289,663	21,642	311,305
Infrastructure	255,082	24,104	279,186
Construction in progress	49,972	92,735	142,707
Water and wastewater distribution	-	300,059	300,059
Less: accumulated depreciation	(228,671)	(259,604)	(488,275)
Total capital assets	<u>805,746</u>	<u>211,715</u>	<u>1,017,461</u>
 Total assets	 <u>2,479,250</u>	 <u>949,370</u>	 <u>3,428,620</u>
LIABILITIES			
Accounts payable	21,609	42,783	64,392
Accrued liabilities	57,989	1,686	59,675
Customer deposits	-	74,365	74,365
Noncurrent liabilities:			
Due within one year	29,775	-	29,775
Due in more than one year	<u>69,475</u>	<u>2,268</u>	<u>71,743</u>
Total liabilities	<u>178,848</u>	<u>121,102</u>	<u>299,950</u>
NET ASSETS			
Invested in capital assets, net of related debt	805,746	211,715	1,017,461
Unrestricted	<u>1,494,656</u>	<u>616,553</u>	<u>2,111,209</u>
 Total net assets	 <u>\$ 2,300,402</u>	 <u>\$ 828,268</u>	 <u>\$ 3,128,670</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2011

Functions/Programs	Expenses	Program Revenue		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Governmental activities:				
General government	\$ 570,077	\$ 50,985	\$ 150,570	\$ -
Public safety	515,026	-	1,047	-
Public works	134,277	-	-	-
Judicial	89,819	239,152	-	-
Highways and streets	107,183	-	-	45,628
Culture and recreation	78,026	-	-	-
Total governmental activities	<u>1,494,408</u>	<u>290,137</u>	<u>151,617</u>	<u>45,628</u>
Business-type activities:				
Water/sewer services	<u>528,831</u>	<u>471,079</u>	<u>-</u>	<u>43,789</u>
Total business-type activities	<u>528,831</u>	<u>471,079</u>	<u>-</u>	<u>43,789</u>
Total	<u>\$ 2,023,239</u>	<u>\$ 761,216</u>	<u>\$ 151,617</u>	<u>\$ 89,417</u>

General revenues:

Taxes:

Property taxes, levied for general purposes

Sales taxes

Franchise taxes

Other taxes

Investment earnings

Miscellaneous

Total general revenues

Change in net assets

Net assets - beginning

Net assets - ending

The accompanying notes are an integral part of these financial statements.

Net (Expense) Revenue and Changes in Net Assets

Governmental Activities	Business-type Activities	Total
\$(368,522) (513,979) (134,277) 149,333 (61,555) (78,026) <u>(1,007,026)</u>	\$ - - - - - - <u>-</u>	\$(368,522) (513,979) (134,277) 149,333 (61,555) (78,026) <u>(1,007,026)</u>
-	<u>(13,963)</u>	<u>(13,963)</u>
-	<u>(13,963)</u>	<u>(13,963)</u>
<u>(1,007,026)</u>	<u>(13,963)</u>	<u>(1,020,989)</u>
\$ 804,855 65,418 89,076 4,144 4,932 <u>5,992</u> <u>974,417</u>	\$ - - - - 2,617 <u>34,247</u> <u>36,864</u>	\$ 804,855 65,418 89,076 4,144 7,549 <u>40,239</u> <u>1,011,281</u>
(32,609)	22,901	(9,708)
<u>2,333,011</u>	<u>805,367</u>	<u>3,138,378</u>
<u>\$ 2,300,402</u>	<u>\$ 828,268</u>	<u>\$ 3,128,670</u>

CITY OF SHOREACRES, TEXAS

BALANCE SHEET

GOVERNMENTAL FUNDS

SEPTEMBER 30, 2011

	<u>General</u>
ASSETS	
Cash	\$ 384,440
Investments	1,184,756
Taxes receivable, net	60,954
Due from other funds	28,225
Receivable from other governments	259,173
Fines receivables	71,729
Other receivables	<u>1,825</u>
Total assets	<u>\$ 1,991,102</u>
LIABILITIES AND FUND BALANCES	
Liabilities:	
Accounts payable	21,609
Due to other funds	317,598
Accrued liabilities	57,989
Deferred revenue	<u>57,863</u>
Total liabilities	<u>455,059</u>
Fund balances:	
Unassigned	<u>1,536,043</u>
Total fund balances	<u>1,536,043</u>
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	805,746
Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the funds.	57,863
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.	<u>(99,250)</u>
Net assets of governmental activities	<u>\$ 2,300,402</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	<u>General</u>
REVENUES	
Taxes:	
Property	\$ 803,020
Sales	65,418
Franchise	89,076
Other	4,144
Fines and fees	264,364
Intergovernmental	197,245
Lease and rental	21,900
Licenses and permits	29,085
Investment earnings	4,932
Miscellaneous	5,992
Total revenues	1,485,176
EXPENDITURES	
Current:	
General government	563,449
Judicial	89,380
Public safety	481,498
Public works	114,455
Highways and streets	103,128
Culture and recreation	69,098
Capital outlay	206,074
Total expenditures	1,627,082
EXCESS (DEFICIENCY) OF REVENUES	
 OVER (UNDER) EXPENDITURES	(141,906)
OTHER FINANCING SOURCES AND USES	
Proceeds from insurance	21,782
Proceeds from the sale of capital assets	6,952
Total other financing sources and uses	28,734
NET CHANGE IN FUND BALANCES	(113,172)
FUND BALANCES, BEGINNING	1,649,215
FUND BALANCES, ENDING	\$ 1,536,043

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES**

FOR THE YEAR ENDED SEPTEMBER 30, 2011

Amounts reported for governmental activities in the Statement of Activities are different because:

Net change in fund balances - total governmental funds	\$(113,172)
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	118,792
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	<u>(23,377)</u>
Change in net assets of governmental activities	<u>\$(32,609)</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS

STATEMENT OF NET ASSETS

PROPRIETARY FUND

SEPTEMBER 30, 2011

	<u>Business-type Activities Enterprise Fund Water and Sewer</u>
ASSETS	
Current assets:	
Cash	\$ 317,431
Accounts receivable, net	130,851
Due from other funds	<u>315,506</u>
Total current assets	<u>763,788</u>
Non-current assets:	
Capital assets:	
Buildings and improvements	5,000
Vehicles and equipment	21,642
Water and wastewater distribution	300,059
Land improvements	19,940
Land	7,839
Infrastructure	24,104
Construction in progress	92,735
Less accumulated depreciation	<u>(259,604)</u>
Total non-current assets	<u>211,715</u>
Total assets	<u>975,503</u>
LIABILITIES	
Current liabilities:	
Accounts payable	42,783
Accrued liabilities	1,686
Due to other funds	26,133
Customer deposits	<u>74,365</u>
Total current liabilities	<u>144,967</u>
Non-current liabilities:	
Compensated absences	<u>2,268</u>
Total liabilities	<u>147,235</u>
NET ASSETS	
Invested in capital assets	211,715
Unrestricted	<u>616,553</u>
Total net assets	<u>\$ 828,268</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

PROPRIETARY FUND

FOR THE YEAR ENDED SEPTEMBER 30, 2011

	<u>Business-type Activities Enterprise Fund Water and Sewer</u>
OPERATING REVENUES	
Charges for sales and services:	
Water	\$ 321,268
Sewer	93,115
Sanitation	56,696
Total operating revenues	<u>471,079</u>
OPERATING EXPENSES	
Personnel services	144,530
Water services	152,926
Solid waste disposal	95,412
Recycling services	12,300
Materials and supplies	51,829
Maintenance	3,676
Fuel	5,585
Utilities	32,705
Depreciation	10,362
Other	19,506
Total operating expenses	<u>528,831</u>
OPERATING LOSS	<u>(57,752)</u>
NON-OPERATING REVENUES (EXPENSES)	
Investment income	2,617
Miscellaneous revenues	34,247
Total non-operating revenues (expenses)	<u>36,864</u>
CONTRIBUTED CAPITAL	<u>43,789</u>
CHANGE IN NET ASSETS	22,901
TOTAL NET ASSETS, BEGINNING	<u>805,367</u>
TOTAL NET ASSETS, ENDING	<u>\$ 828,268</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS
STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Business-type Activities Enterprise Fund <u>Water and Sewer</u>
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from customers	\$ 398,623
Cash payments to employees for services	(147,643)
Cash payments to suppliers for goods and services	(463,195)
Cash used by operating activities	<u>(212,215)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Miscellaneous revenues	<u>34,247</u>
Cash provided by noncapital financing activities	<u>34,247</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	(24,104)
Cash used by capital and related financing activities	<u>(24,104)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest on investments	<u>2,617</u>
Cash provided by investing activities	<u>2,617</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(199,455)
CASH, BEGINNING	<u>516,886</u>
CASH, ENDING	<u>\$ 317,431</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED BY OPERATING ACTIVITIES	
Operating loss	\$(57,752)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation	10,362
Change in assets and liabilities:	
Decrease (increase) in accounts receivable	(79,765)
Decrease (increase) in due from other funds	(143,466)
Increase (decrease) in accounts payable	28,077
Increase (decrease) in customer deposits	7,309
Increase (decrease) in due to other funds	-
Increase (decrease) in accrued liabilities	3
Increase (decrease) in compensated absences	<u>23,017</u>
Total adjustments	<u>(154,463)</u>
Net cash used by operating activities	<u>\$(212,215)</u>
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES	
Contributions of capital assets from government	<u>\$ 43,789</u>

The accompanying notes are an integral part of these financial statements.

CITY OF SHOREACRES, TEXAS

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Shoreacres, Texas (the "City") was incorporated as a City in 1949 and is a General Law City with a Mayor and five Council members elected to two-year terms. City Hall acts as a courthouse, council chambers, meeting room, police station, and administrative building.

A. Reporting Entity

Generally accepted accounting principles require financial statements to present the government and its component units, entities for which the government is considered financially accountable. Examination of potential component units determined that none met the criteria necessary for inclusion in these financial statements.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government. Governmental activities, which normally are supported by taxes, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

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

Separate financial statements are provided for Governmental Funds and Proprietary Funds. Major individual Governmental Funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

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

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the Proprietary Fund financial statements. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

(continued)

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

C. **Measurement Focus, Basis of Accounting, and Financial Statement Presentation** (Continued)

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

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

The City reports the following major Governmental Fund:

General Fund – The General Fund is the City’s primary operating fund. It is used to account for all financial resources of the general government except those required to be accounted for in another fund.

The City reports the following major Proprietary Fund:

Water/Sewer Fund – The Water/Sewer Fund accounts for the operations of providing water, sewer, and waste management services to the residents of the City.

Private-sector standards of accounting and financial reporting issued prior to December 31, 1989, generally are followed in both the government-wide and Proprietary Fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

Governments also have the option of following subsequent private-sector guidance for their business-type activities and Enterprise Fund, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

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

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

D. Assets, Liabilities, and Net Assets or Equity

Deposits and Investments

The City's cash and cash equivalents are considered to be cash on hand, demand and savings accounts, and certificates of deposits.

The short-term investments consist of deposits in the Texas Local Government Investment Pool (TexPool). In accordance with GASB Statement No. 31, the City reports all investments at fair value except for money market investments and "2a7-like pools." The City had no money market investments at year-end. Investment positions in external investment pools that are operated in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940, such as TexPool, Logic, and TexStar, are reported using the pools' share price.

The City has adopted a policy whereby investments are limited to the instruments listed below and as further described by the Public Funds Investment Act.

- a. Obligations of the United States Government, its agencies and instrumentalities, and government sponsoring enterprises, not to exceed two years to stated maturity, excluding collateralized mortgage obligations (CMOs).
- b. Full insured or collateralized certificates of deposit from a bank doing business in the State of Texas and under the terms of a written depository agreement with that bank, not to exceed two years to stated maturity.
- c. No-load, SEC registered money market funds, each approved specifically before use by the City.
- d. Constant dollar Texas Local Government Investment Pools as defined by Public Funds Investment Act.

(continued)

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Receivables and Payables

Activity between funds is reported as due to/from other funds. The outstanding balances between funds result mainly from (1) the arrangement whereby one cash account is used for payroll processing for all funds and, (2) in other cases the General Fund will pay an expenditure of the Water/Sewer Fund or vice versa. The balance in the due to/from other funds accounts is not expected to be paid back within one year.

All accounts receivable are shown net of an allowance for uncollectibles.

Capital Assets

Capital assets, which include buildings and improvements, machinery and equipment, and infrastructure assets (e.g. roads, bridges, sidewalks, and similar items) 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 City chose not to report general infrastructure assets retroactively, as permitted by GASB Statement No. 34 for smaller governments. The City will prospectively report general infrastructure assets acquired or constructed after October 1, 2003, in the statement of net assets in the period they acquire or construct those assets.

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

Capital assets of the City are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and improvements	10-30
Machinery and equipment	3-20
Water facilities	20-40
Vehicles	5
Infrastructure	20-30

Fund Balance Classification

The governmental fund financial statements present fund balances based on classifications that comprise a hierarchy that is based primarily on the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the respective governmental funds can be spent. The classifications used in the governmental fund financial statements are as follows:

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Fund Balance Classification (Continued)

- **Nonspendable:** This classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) are legally or contractually required to be maintained intact. Nonspendable items are not expected to be converted to cash or are not expected to be converted to cash within the next year.
- **Restricted:** This classification includes amounts for which constraints have been placed on the use of the resources either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation.
- **Committed:** This classification includes amounts that can be used only for specific purposes pursuant to constraints imposed by board resolution of the city Council, the City's highest level of decision making authority. These amounts cannot be used for any other purpose unless the City Council removes or changes the specified use by taking the same type of action that was employed when the funds were initially committed. This classification also includes contractual obligations to the extent that existing resources have been specifically committed for use in satisfying those contractual requirements.
- **Assigned:** This classification includes amounts that are constrained by the City's intent to be used for a specific purpose but are neither restricted nor committed. This classification includes amounts that are constrained by the City's intent to be used for a specific purpose but are neither restricted nor committed. This intent can be expressed by the City Council or City Administrator.
- **Unassigned:** This classification includes the residual fund balance for the General Fund. The unassigned classification also includes negative residual fund balance of any other governmental fund that cannot be eliminated by offsetting of assigned fund balance amounts.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the City considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the City considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any borrowing used for the acquisition, construction or improvements of those assets, and adding back unspent proceeds. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislations adopted by the City through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Budgetary Information

Prior to the beginning of each fiscal year, the City Administrator submits to the City Council a proposed budget for the General Fund. The City Council uses this as a basis to formulate the operating budget for the upcoming year, which includes proposed expenditures and the means of financing those expenditures.

Public hearings are conducted at which all interested persons' comments concerning the budget are heard.

The budget is legally enacted by the City Council. Budgetary control is maintained at the fund level. All annual appropriations lapse at fiscal year-end.

3. DETAILED NOTES ON ALL FUNDS

Cash and Investments

As of September 30, 2011, the city had the following cash and investments:

	<u>Fair Value</u>	<u>Weighted Average Maturity (Days)</u>
Investments - TexPool	\$ <u>1,184,756</u>	44
Total fair value	\$ <u>1,184,756</u>	

During the year ended September 30, 2011, the City invested in the Texas Local Government Pool (TexPool), which is investment funds authorized by the Texas Legislature. TexPool is administered by the Texas State Treasury and holds investments which are subject to the same investment policies maintained by the State Treasury for all state funds. The Texas Treasury Safekeeping Trust Company is the trustee and is a limited purpose trust company authorized pursuant to Texas Government Code. The purpose of investment pool funds is to allow for the pooling of public funds to provide a higher yield on the pooled investment than would be possible with the investment of the individual public entity's funds. The legislature has authorized only certain investment instruments for public funds, including repurchase agreements, U. S. Treasury bills and bonds, securities of other U. S. government agencies, commercial paper, and other safe instruments. The investments held in TexPool, plus any accrued interest may be redeemed at the City's discretion. TexPool is rated AAAM by Standard & Poors. As a requirement to maintain the weekly rating portfolio, information must be submitted to Standard & Poors, as well as the office of the Comptroller of Public accounts, for review. TexPool operates in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The funds use amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in TexPool is the same as the value of TexPool shares.

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Cash and Investments (Continued)

Interest Rate Risk: To limit the City's exposure to interest rate risk and ensure liquidity, the City's investment policy requires that the City's investments be structured so that the maximum weighted average maturity of the overall portfolio may not exceed six months. Furthermore, the investment policy states the investment portfolio should be designed with the objective of attaining a market rate of return taking into account the City's risk constraints within State Statutes and the cash flow needs of the portfolio. "Market rate of return" may be defined as the average yield of the current six-month U. S. Treasury bill. Furthermore, the City has a diversification policy which includes diversification standards by security type and issuer.

Credit Risk: At year-end, balances in TexPool, a privately managed public funds investment pool, was rated AAAM by Standard & Poor's.

Custodial Credit Risk: The City of Shoreacres' financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents. The City deposits its cash with high credit quality institutions. However, at times, such instruments may be in excess of FDIC insurance limits. As of September 30, 2011, \$203,349 of the City's \$701,722 deposit balance was collateralized with securities held by the pledging financial institution. The remaining \$500,000 was covered by FDIC insurance.

Property Taxes

The appraisal of property within the City is the responsibility of the Harris County Appraisal District (the "District"). The District is required under the Property Tax Code to assess all property within the District on the basis of 100% of its appraised value and is prohibited from applying any assessment ratios. The value of property within the District must be reviewed every four years.

The City's property tax is levied each October 1 on the assessed value listed as of the prior January 1 for all real and business personal property located in the City. The net assessed value upon which the fiscal 2011 levy was based was \$95,475,519.

Taxes are due by January 31 following the October 1 levy date. Current tax collections for the year ended September 30, 2011, were 98% of the tax levy.

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Receivables

Receivables as of year-end for the City's individual major funds, including the applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Utility</u>	<u>Total</u>
Receivables:			
Taxes	\$ 62,006	\$ -	\$ 62,006
Water/sewer usage	-	134,898	134,898
Intergovernmental	259,173	-	259,173
Fines	286,917	-	286,917
Lease and rentals	<u>1,825</u>	<u>-</u>	<u>1,825</u>
Gross receivables	609,921	134,898	744,819
Less: allowance for uncollectibles	<u>(216,240)</u>	<u>(4,047)</u>	<u>(220,287)</u>
Net total receivables	<u>\$ 393,681</u>	<u>\$ 130,851</u>	<u>\$ 524,532</u>

Governmental funds report deferred revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, deferred revenue not considered available and reported in the governmental funds of \$34,013 is related to property taxes receivable and \$23,850 is related to municipal court receivables.

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Capital Assets

Capital asset activity for the year ended September 30, 2011, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Adjustments</u>	<u>Ending Balance</u>
Governmental activities:					
Capital assets, not being depreciated:					
Land	\$ 175,164	\$ -	\$ -		\$ 175,164
Construction in progress	<u>62,664</u>	<u>17,918</u>	<u>(30,610)</u>	<u>-</u>	<u>49,972</u>
Total assets not being depreciated	<u>237,828</u>	<u>17,918</u>	<u>(30,610)</u>	<u>-</u>	<u>286,356</u>
Capital assets, being depreciated:					
Buildings and improvements	153,379	24,250	-		177,629
Parks	56,297	30,610	-		86,907
Vehicles and equipment	199,475	147,475	(57,287)		289,663
Infrastructure	<u>255,082</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>255,082</u>
Total capital assets being depreciated	<u>664,233</u>	<u>202,335</u>	<u>(57,287)</u>	<u>-</u>	<u>809,281</u>
Less accumulated depreciation:					
Buildings and improvements	(12,653)	(3,939)	-		(16,592)
Parks	(28,219)	(8,875)	-		(37,094)
Vehicles and equipment	(140,917)	(31,094)	50,542	(3,193)	(121,469)
Infrastructure	<u>(33,318)</u>	<u>(17,005)</u>	<u>-</u>	<u>-</u>	<u>(50,323)</u>
Total accumulated depreciation	<u>(215,107)</u>	<u>(60,913)</u>	<u>50,542</u>	<u>(3,193)</u>	<u>(228,671)</u>
Total capital assets being depreciated, net	<u>449,126</u>	<u>141,422</u>	<u>(6,745)</u>	<u>(3,193)</u>	<u>583,803</u>
Governmental activities capital					

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Capital Assets (Continued)

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Business-type activities:				
Capital assets, not being depreciated:				
Land				
Construction in progress				
Total assets not being depreciated	\$ 7,839	\$ -	\$ -	\$ 7,839
	<u>48,946</u>	<u>43,789</u>	<u>-</u>	<u>92,735</u>
Capital assets, being depreciated:	<u>56,785</u>	<u>43,789</u>	<u>-</u>	<u>100,574</u>
Buildings and improvements				
Infrastructure				
Land improvements	5,000	-	-	5,000
Water facilities	-	24,104	-	24,104
Vehicles and equipment	19,940	-	-	19,940
Total capital assets being depreciated	300,059	-	-	300,059
	<u>21,642</u>	<u>-</u>	<u>-</u>	<u>21,642</u>
Less accumulated depreciation:	<u>346,641</u>	<u>24,104</u>	<u>-</u>	<u>370,745</u>
Buildings and improvements				
Infrastructure				
Land improvements	(5,000)	-	-	(5,000)
Water facilities	-	(100)	-	(100)
Vehicles and equipment	(4,291)	(1,329)	-	(5,620)
Total accumulated depreciation	(233,255)	(5,382)	-	(238,637)
	<u>(6,696)</u>	<u>(3,551)</u>	<u>-</u>	<u>(10,247)</u>
Total capital assets being depreciated, net	<u>(249,242)</u>	<u>(10,362)</u>	<u>-</u>	<u>(259,604)</u>

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

Governmental activities:	
Public works	\$ 19,822
General government administration	7,942
Public safety	20,218
Highways and streets	4,055
Culture and recreation	<u>8,876</u>
Total depreciation expense - governmental activities	<u>\$ 60,913</u>

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Interfund Receivables, Payables and Transfers

The composition of interfund balances as of September 30, 2011, is as follows:

Due to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Water and Sewer	General	\$ 317,598
General	Water and Sewer	\$ 28,225

The interfund balance resulted from the time lag between the dates that 1) interfund goods and services are provided on reimbursable expenditures occur, and 2) transactions are recorded in the accounting system, and 3) payments between fund are made.

Long-term Debt

The following is a summary of changes in long-term debt for the year ended September 30, 2011:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending Balance</u>	<u>Amounts Due in One Year</u>
Governmental activities					
Compensated absences	\$ 84,398	\$ 14,852	\$ -	\$ 99,250	\$ 29,775
Total governmental activities	<u>\$ 84,398</u>	<u>\$ 14,852</u>	<u>\$ -</u>	<u>\$ 99,250</u>	<u>\$ 29,775</u>
Business-type activities					
Compensated absences	\$ 5,384	\$ -	\$ 3,116	\$ 2,268	\$ -
Total governmental activities	<u>\$ 5,384</u>	<u>\$ -</u>	<u>\$ 3,116</u>	<u>\$ 2,268</u>	<u>\$ -</u>

Employee Benefit Plan

Plan Description

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

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Employee Benefit Plan (Continued)

Plan Description (Continued)

TMRS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information (RSI) for TMRS; the report also provides detailed explanations of the contributions, benefits and actuarial methods and assumptions used by the System. This report may be obtained by writing to TMRS, P. O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677; in addition, the report is available on TMRS' website at www.TMRS.com.

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

	<u>Plan Year 2010</u>	<u>Plan Year 2011</u>
Employee deposit rate	5.0%	5.0%
Matching ratio (city to employee)	1.5 to 1	1.5 to 1
Years required for vesting	5	5
Service retirement eligibility (expressed as age/years of service)	60/5, 0/20	60/5, 0/20
Updated service credit	100% repeating, transfers	100% repeating, transfers
Annuity increase (to retirees)	70% of CPI repeating	70% of CPI repeating

Contributions

Under the state law governing TMRS, the contribution rate for each City is determined annually by the actuary, using the Projected Unit Credit actuarial cost method. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, which is calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the portion of an active member's projected benefit allocated annually; the prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the applicable period for that city. Both the normal cost and prior service contribution rates include recognition of the projected impact of annually repeating benefits, such as Updated Service Credits and Annuity Increases.

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Employee Benefit Plan (Continued)

Contributions (Continued)

The City contributes to the TMRS Plan at an actuarially determined rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that serves as the basis for the rate and the calendar year when the rate goes into effect. The annual pension cost and net pension obligation/(asset) are as follows:

Accounting Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
09/30/09	\$ 29,288	100%	-
09/30/10	39,141	100%	-
09/30/11	41,067	100%	-

The required contribution rates for fiscal year 2011 were determined as part of the December 31, 2008 and 2009 actuarial valuations. Additional information as of the latest actuarial valuation, December 31, 2010, also follows:

Actuarial Valuation Date	12/31/08	12/31/09	12/31/10 - prior to restructuring	12/31/10 - restructured
Actuarial cost method	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit	Projected Unit Credit
Amortization method	Level percent of payroll	Level percent of payroll	Level percent of payroll	Level percent of payroll
GASB 25 Equivalent Single Amortization period	29 years - closed	27.6 years - closed	26 years - closed	25.7 years - closed
Amortization Period for new Gains/Losses	30 years	30 years	30 years	22 years
Asset valuation method	Amortized cost	10-year smoothed market	10-year smoothed market	10-year smoothed market
Actuarial Assumptions:				
Investment rate of return	7.5%	7.5%	7.5%	7.0%
Projected salary increases	varies by age and service	varies by age and service	varies by age and service	varies by age and service
Inflation	3.0%	3.0%	3.0%	3.0%
Cost-of-living adjustments	2.1%	2.1%	2.1%	2.1%
Payroll growth	3.0%	3.0%	3.0%	3.0%
Withdrawal rates for male/female	Mid-Low/Mid	Mid-Low/Mid	Mid-Low/Mid	Mid-Low/Mid

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Employee Benefit Plan (Continued)

Funded Status and Funding Progress

In June, 2011, SB 350 was enacted by the Texas Legislature, resulting in a restructure of the TMRS funds. This legislation provided for the actuarial valuation to be completed, as if restructuring had occurred on December 31, 2010. In addition, the actuarial assumptions were updated for the new fund structure, based on an actuarial experience study that was adopted by the TMRS Board at their May, 2011 meeting (the review compared actual to expected experience for the four-year period of January 1, 2006 through December 31, 2009). For a complete description of the combined impact of the legislation and new actuarial assumptions, including the effects on TMRS city rates and funding ratios, please see the December 31, 2010 TMRS Comprehensive Annual Financial Report (CAFR).

The funded status as of December 31, 2010, under the two separate actuarial valuations, is presented as follows:

Actual Valuation Date	12/31/10 (2)	12/31/10 (1)	12/31/09	12/31/08
Actuarial value of assets	\$ 1,057,752	\$ 921,716	\$ 809,579	\$ 719,621
Actuarial accrued liability	1,146,532	1,043,893	962,023	890,121
Percent funded	92.3%	88.3%	84.2%	80.8%
Unfunded (overfunded) actuarial accrued liability (UAAL)	88,780	122,177	152,444	170,500
Annual covered payroll	574,870	574,870	614,106	576,144
UAAL as a percentage of covered payroll	15.4%	21.3%	24.8%	29.6%

(1) Actuarial valuation performed under the original fund structure.

(2) Actuarial valuation performed under the new structure.

Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City has joined together with other governments in Texas to form the Texas Municipal League Intergovernmental Risk Pool, a public entity risk pool currently operating as a common risk management and insurance program for liability, property, and workers' compensation coverage. The City pays a quarterly contribution to the pool for its insurance coverage. The agreement for formation of the Texas Municipal League Intergovernmental Risk Pool provides that the Pool will be self-sustaining through member contributions and will reinsure through commercial companies for claims in excess of specific limits.

The Texas Municipal League Intergovernmental Risk Pool has published its own financial report, which can be obtained by writing the Texas Municipal League Intergovernmental Risk Pool, 1821 Rutherford Lane, Austin, Texas 78754.

(continued)

3. DETAILED NOTES ON ALL FUNDS (Continued)

Other Postemployment Benefits

Supplemental Death Benefits Fund

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

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

Schedule of Contribution Rates

<u>Accounting Year Ending</u>	<u>Annual Required Contribution (Rate)</u>	<u>Actual Contribution Made (Rate)</u>	<u>Percentage of ARC Contributed</u>
09/30/09	.02%	.02%	100%
09/30/10	.02%	.02%	100%
09/30/11	.02%	.02%	100%

**REQUIRED
SUPPLEMENTARY INFORMATION**

CITY OF SHOREACRES, TEXAS

GENERAL FUND

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL**

FOR THE YEAR ENDED SEPTEMBER 30, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance with Final Budget Positive (Negative)</u>
REVENUES				
Taxes:				
Property	\$ 756,011	\$ 756,011	\$ 803,020	\$ 47,009
Sales	62,500	62,500	65,418	2,918
Franchise	74,000	74,000	89,076	15,076
Other	3,000	3,000	4,144	1,144
Fines and fees	366,550	366,550	264,364	(102,186)
Intergovernmental	5,567,570	5,567,570	197,245	(5,370,325)
Lease and rental	21,900	21,900	21,900	-
Licenses and permits	36,000	36,000	29,085	(6,915)
Investment earnings	8,900	8,900	4,932	(3,968)
Miscellaneous	15,000	15,000	5,992	(9,008)
Total revenues	<u>6,911,431</u>	<u>6,911,431</u>	<u>1,485,176</u>	<u>(5,426,255)</u>
EXPENDITURES				
Current:				
General government	1,482,732	1,482,732	563,449	919,283
Judicial	131,820	131,820	89,380	42,440
Public safety	779,748	779,748	481,498	298,250
Public works	4,606,866	4,606,866	114,455	4,492,411
Highways and streets	125,731	125,731	103,128	22,603
Culture and recreation	54,954	54,954	69,098	(14,144)
Capital outlay	297,774	297,774	206,074	91,700
Total expenditures	<u>7,479,625</u>	<u>7,479,625</u>	<u>1,627,082</u>	<u>5,852,543</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>(568,194)</u>	<u>(568,194)</u>	<u>(141,906)</u>	<u>426,288</u>
OTHER FINANCING SOURCES (USES)				
Proceeds from insurance	-	-	21,782	21,782
Proceeds from sale of capital assets	-	-	6,952	6,952
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>28,734</u>	<u>28,734</u>
NET CHANGE IN FUND BALANCE	<u>(568,194)</u>	<u>(568,194)</u>	<u>(113,172)</u>	<u>455,022</u>
FUND BALANCE, BEGINNING	<u>1,649,215</u>	<u>1,649,215</u>	<u>1,649,215</u>	<u>-</u>
FUND BALANCES, ENDING	<u>\$ 1,081,021</u>	<u>\$ 1,081,021</u>	<u>\$ 1,536,043</u>	<u>\$ 455,022</u>

CITY OF SHOREACRES, TEXAS

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2011

SUMMARY OF BUDGET AND BUDGETARY BASIS OF ACCOUNTING

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

1. Prior to the beginning of each fiscal year, the City Council prepares a proposed budget for the fiscal year beginning on the following October 1. The proposed budget includes estimated revenue and proposed expenditures for the General and Water and Sewer Funds.
2. Public hearings are conducted to obtain taxpayer comments.
3. The budget is legally adopted by the City Council.
4. The City Council can adjust the budget during formal City Council meetings.
5. Actual expenditures cannot exceed the legally adopted budget without an approved resolution by the City Council.
6. Appropriations lapse at year-end.
7. Budgets are adopted on a basis consistent with generally accepted accounting principles.

COMPLIANCE SECTION



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

To the Honorable Mayor and
Members of the City of Council
City of Shoreacres, Texas

We have audited the financial statements of the governmental activities, the business-type activities, and each major fund of the City of Shoreacres, Texas, as of and for the year ended September 30, 2011, which collectively comprise the City of Shoreacres, Texas' basic financial statements and have issued our report thereon dated April 20, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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. We consider the deficiency described in the accompanying Schedule of Findings and Responses (Item 2011-2) to be a material weakness.

A *significant deficiency* is a deficiency, or 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. We consider the deficiency described in the accompanying Schedule of Findings and Responses (Item 2011-1) to be significant deficiency.

Compliance and Other Matters

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

The City of Shoreacres, Texas' response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the City of Shoreacres, Texas' responses and, accordingly, we express no opinion on it.

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

Pattillo, Brown + Hill, L.L.P.

April 20, 2012

CITY OF SHOREACRES, TEXAS
SCHEDULE OF FINDINGS AND RESPONSES
FOR THE YEAR ENDED SEPTEMBER 30, 2011

Item 2011-1

Condition: During the audit, we noted that no accruals were made at year end for receivables or liabilities nor were general ledger balances reconciled to subsidiary ledgers (accounts payable, accounts receivable, capital assets, etc.).

Effect: Without the proper accrual of receivables and liabilities and reconciliations to the subsidiary ledgers, revenues and expenditures may be incorrectly posted or posted to the wrong period.

Cause: The City was operating on a modified cash basis prior to the need for an audit and therefore did not post accruals for receivables or liabilities other than standard accounts payable at year end. This was operationally sufficient for many years but due to compliance requirements the City must now report on a full accrual basis.

Recommendation: The City should create procedures to properly accrue receivables and payables in order to ensure reporting of items in the proper fiscal period. Furthermore, the City should implement procedures to reconcile subsidiary ledgers to the general ledger on a monthly basis and correct any variances in a timely manner.

Management's Response: The City has had no prior audit or financial reporting requirement to bring forward the issue of year-end accruals and, therefore, has never made them. In addition, the City operated on a modified cash basis, and therefore did not have significant subsidiary ledgers with which to reconcile. Given the present compliance situation, the City will put in place procedures to assure the booking of receivables and payables each year end and monthly reconciliations.

Contact Person Responsible
for Corrective Action: David Stall, City Administrator

Anticipated Completion
Date: Procedures to enter year-end receivables and payables will be created on or before October 1, 2011.

Current Status: There has been significant improvement in this area. Although we had to adjust some receivables at year-end, it was less than in past years. The City should continue towards the goal of adjusting all receivables at year-end.

CITY OF SHOREACRES, TEXAS
SCHEDULE OF FINDINGS AND RESPONSES
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2011

Item 2011-2

Condition: The City has limited staff and therefore in some instances does not have proper segregation of duties. This is especially relevant with respect to the City secretary who receives and posts municipal court receipts and the City administrator who has recording abilities, authorization abilities and custody over cash.

Effect: Without proper segregation of duties, the City is increasing its exposure to fraud risk.

Cause: The City lacks proper segregation of duties to mitigate fraud risk.

Recommendation: The City should implement controls in order to circumvent fraud through not only the proper segregation of duties but through the use of other detection and prevention mechanisms such as reconciliations and checks and balances by unrelated staff.

Management's Response: Currently, there are only 4 office staff so, if one is sick or on vacation, the others must have the ability to perform sensitive tasks such as enter payroll and/or handle cash. There are mitigating factors present such as control/batch totals and comparisons. The City's procedures will be reviewed to determine what improvements can be considered in segregating custodial, recording and authorizing activities.

Contact Person Responsible
for Corrective Action: David Stall, City Administrator

Anticipated Completion
Date: The City will conduct a review of its procedures on or before October 1, 2012.

Condition: In addition to the factor mentioned above, the lack of segregation of duties came up in the utility department in FY 2011. The City discovered an issue that involved several meters around the City not being read. The meter readers, who no longer work with the City, were putting a base amount in for usage and not reading the meter. This caused the City to have large amounts of water being used by customers and those customers not being billed for the proper usage. There were several factors that made this fact very difficult to discover, but ultimately a lack of controls was the main issue. After this issue was discovered, the City made changes to their personnel and control structure over the utility department. These controls should greatly reduce the risk of similar issues occurring again in future periods.

CITY OF SHOREACRES, TEXAS

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

FOR THE YEAR ENDED SEPTEMBER 30, 2011

Item 2010-1

Condition: During the audit, we noted that no accruals were made at year end for receivables or liabilities nor were general ledger balances reconciled to subsidiary ledgers (accounts payable, accounts receivable, capital assets, etc.).

Effect: Without the proper accrual of receivables and liabilities and reconciliations to the subsidiary ledgers, revenues and expenditures may be incorrectly posted or posted to the wrong period.

Cause: The City was operating on a modified cash basis prior to the need for an audit and therefore did not post accruals for receivables or liabilities other than standard accounts payable at year end. This was operationally sufficient for many years but due to compliance requirements the City must now report on a full accrual basis.

Recommendation: The City should create procedures to properly accrue receivables and payables in order to ensure reporting of items in the proper fiscal period. Furthermore, the City should implement procedures to reconcile subsidiary ledgers to the general ledger on a monthly basis and correct any variances in a timely manner.

Management's Response: The City has had no prior audit or financial reporting requirement to bring forward the issue of year-end accruals and, therefore, has never made them. In addition, the City operated on a modified cash basis, and therefore did not have significant subsidiary ledgers with which to reconcile. Given the present compliance situation, the City will put in place procedures to assure the booking of receivables and payables each year end and monthly reconciliations.

Contact Person Responsible
for Corrective Action: David Stall, City Administrator

Anticipated Completion
Date: Procedures to enter year-end receivables and payables will be created on or before October 1, 2011.

Current Status: See item 2011-1.

(continued)

CITY OF SHOREACRES, TEXAS

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
(Continued)
FOR THE YEAR ENDED SEPTEMBER 30, 2011**

Item 2010-2

Condition: The City has limited staff and therefore in some instances does not have proper segregation of duties. This is especially relevant with respect to the City secretary who receives and posts municipal court receipts and the City administrator who has recording abilities, authorization abilities and custody over cash.

Effect: Without proper segregation of duties, the City is increasing its exposure to fraud risk.

Cause: The City lacks proper segregation of duties to mitigate fraud risk.

Recommendation: The City should implement controls in order to circumvent fraud through not only the proper segregation of duties but through the use of other detection and prevention mechanisms such as reconciliations and checks and balances by unrelated staff.

Management's Response: Currently, there are only 4 office staff so, if one is sick or on vacation, the others must have the ability to perform sensitive tasks such as enter payroll and/or handle cash. There are mitigating factors present such as control/batch totals and comparisons. The City's procedures will be reviewed to determine what improvements can be considered in segregating custodial, recording and authorizing activities.

Contact Person Responsible
for Corrective Action: David Stall, City Administrator

Anticipated Completion
Date: The City will conduct a review of its procedures on or before October 1, 2011.

Current Status: See item 2011-2.