

CITY OF ELKHART, TEXAS
BASIC FINANCIAL STATEMENTS AND REQUIRED
SUPPLEMENTARY AND OTHER INFORMATION

FISCAL YEAR ENDED SEPTEMBER 30, 2016

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**CITY OF ELKHART, TEXAS
TABLE OF CONTENTS
SEPTEMBER 30, 2016**

| | <u>Exhibit or Schedule</u> | <u>Page(s)</u> |
|---|--------------------------------|----------------|
| FINANCIAL SECTION | | |
| Independent Auditors' Report | | 1-2 |
| Management's Discussion and Analysis | | 3-7 |
| Basic Financial Statements | | |
| Government-wide Financial Statements: | | |
| Statement of Net Position | 1 | 8 |
| Statement of Activities | 2 | 9 |
| Fund Financial Statements: | | |
| Balance Sheet – Governmental Funds | 3 | 10-11 |
| Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds | 4 | 12 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes In Fund Balances of Governmental Funds to the Statement of Activities | 5 | 13 |
| Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual – General Fund | 6 | 14 |
| Statement of Net Assets – Proprietary Funds | 7 | 15 |
| Statement of Revenues, Expenses, and Changes in Fund Net Assets – Proprietary Funds | 8 | 16 |
| Statement of Cash Flows – Proprietary Funds | 9 | 17 |
| Notes to the Financial Statements | | 18-37 |
| Required Supplementary Information | | |
| Schedule of Changes in Net Pension Liability and Related Ratios | A-1 | 38 |
| Schedule of Contributions | A-2 | 39 |
| Compliance and Internal Controls Section | | |
| Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Governmental Auditing Standards</i> | | 40-41 |



INDEPENDENT AUDITORS' REPORT

To the City Council
City of Elkhart, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Elkhart, Texas, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the City of Elkhart, Texas' basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

The City of Elkhart, Texas' 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.

Auditors' 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 auditors' 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, each major fund, and the aggregate remaining fund information of the City of Elkhart, Texas, as of September 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information, such as management's discussion and analysis on pages 3-7 and schedules of pension liabilities and contributions on pages 38-39 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Elkhart, Texas' basic financial statements. The additional supplemental information is present for purposes of additional analysis and is not a required part of the basic financial statements.

The additional supplemental 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. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional supplemental information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 17, 2018 on our consideration of the City of Elkhart, Texas' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City of Elkhart, Texas' internal control over financial reporting and compliance.



Certified Public Accountants

Tyler, Texas
September 17, 2018

REQUIRED SUPPLEMENTARY INFORMATION
MANAGEMENT'S DISCUSSION AND ANALYSIS

**CITY OF ELKHART, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

As management of City of Elkhart, Texas (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended September 30, 2016. We encourage readers to consider information presented here as well as the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The overall assets of the City decreased by \$26,607 during the fiscal year. However, of this amount, cash and other current assets increased by \$169,530.
- The City's total long-term debt obligations decreased by \$112,350 during the current fiscal year. Total debt outstanding at year end was \$572,965; \$453,000 in bond obligations, \$98,592 in net pension liability, and \$21,373 in capital lease obligations.
- The City's overall assets exceeded its total liabilities by \$3,317,665 (*net position*) at September 30, 2016. Of this amount, \$522,012 (*unrestricted net position*) may be used to meet the on-going obligations to citizens and creditors.
- Excluding grant revenues received, overall revenues decreased by \$22,931 from the prior year. A decrease in the charges for services and in franchise fees accounted for the majority of the decrease.
- Overall revenues exceeded expenses (or an increase in net position) by \$121,077. Net position increased by \$291,313 in the governmental fund and decreased by \$170,236 in the proprietary fund.

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 8 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 position* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. However, other nonfinancial factors must also be considered.

The *statement of activities* presents information showing how the City's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus all of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

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 reporting requirements. All of the funds of the City can be divided into two categories: *governmental* funds and *proprietary* funds.

**CITY OF ELKHART, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Revenues are recognized when they are both measurable and available. Expenditures are recorded when the related fund liability is incurred, except for general obligation bond principal and interest, which are reported as expenditures in the year due.

Because the focus of governmental funds are 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 City's near term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains two individual governmental funds. Information is presented separately in the government fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances. The general fund is the chief operating fund of the City. At the end of the current year, unassigned fund balance of the general fund was \$487,249, with no amount being restricted. The debt service fund has a total fund balance of \$64,439, all of which is restricted for the payment of debt service.

Proprietary funds are used to report the same functions presented as *business-type* activities in the government-wide financial statements. The City use a proprietary fund to account for the operations of the water, sewer and garbage collections systems that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods and services to the general public on a continuing basis are to be financed or recovered primarily through user charges. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The basic governmental and proprietary fund financial statements can be found on pages 10-17 of this report.

Notes to the Financial Statements.

The notes provided 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 18-37 of this report.

THE CITY'S NET POSITION

Over time, net position may serve as a useful indicator of a government's financial position. At September 30, 2016, the City's assets exceeded its liabilities by \$3,317,665.

The City has a large investment in capital assets (e.g., land, building, equipment, and construction in progress) and related debt used to acquire those assets that remain outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the assets themselves cannot be used to liquidate these liabilities. At year end, net position invested in capital assets, net of related debt, totaled \$2,731,214.

An additional portion of the City's net position, \$64,439, represents resources that are subject to external restriction on how they may be used. The remaining balance is \$522,012 and unrestricted in nature.

**CITY OF ELKHART, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

Statement of Net Position

The following table reflects the condensed Statement of Net Position:

| | Governmental Activities | | Business-Type Activities | | Total | |
|---|-------------------------|-------------------|--------------------------|---------------------|---------------------|---------------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Current and other assets | \$ 569,327 | \$ 363,220 | \$ 226,278 | \$ 262,855 | \$ 795,605 | \$ 626,075 |
| Capital assets | 777,070 | 803,207 | 2,428,517 | 2,598,517 | 3,205,587 | 3,401,724 |
| Total Assets | <u>1,346,397</u> | <u>1,166,427</u> | <u>2,654,795</u> | <u>2,861,372</u> | <u>4,001,192</u> | <u>4,027,799</u> |
| Deferred outflows of resources | 4,592 | 4,090 | 26,594 | 24,057 | 31,186 | 28,147 |
| Long-term liabilities | 365,668 | 479,421 | 84,040 | 82,637 | 449,708 | 562,058 |
| Other liabilities | 127,036 | 124,124 | 137,969 | 173,176 | 265,005 | 297,300 |
| Total Liabilities | <u>492,704</u> | <u>603,545</u> | <u>222,009</u> | <u>255,813</u> | <u>714,713</u> | <u>859,358</u> |
| Net Position: | | | | | | |
| Invested in capital assets, net of related debt | 310,860 | 224,196 | 2,420,354 | 2,576,632 | 2,731,214 | 2,800,828 |
| Restricted | 64,439 | 199 | - | - | 64,439 | 199 |
| Unrestricted | 482,986 | 342,577 | 39,026 | 52,984 | 522,012 | 395,561 |
| Total Net Position | <u>\$ 858,285</u> | <u>\$ 566,972</u> | <u>\$ 2,459,380</u> | <u>\$ 2,629,616</u> | <u>\$ 3,317,665</u> | <u>\$ 3,196,588</u> |

Statement of Activities

The following table provides a summary of the City's changes in net position:

| | Governmental Activities | | Business-Type Activities | | Total | |
|-----------------------------------|-------------------------|-------------------|--------------------------|---------------------|---------------------|---------------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Revenues: | | | | | | |
| Charges for services | \$ - | \$ - | \$ 794,515 | \$ 836,072 | \$ 794,515 | \$ 836,072 |
| Property taxes | 104,027 | 102,807 | - | - | 104,027 | 102,807 |
| Sales tax | 169,477 | 132,877 | - | - | 169,477 | 132,877 |
| Franchise fees | 82,579 | 101,534 | - | - | 82,579 | 101,534 |
| Interest income | 24 | 15 | 6 | 28 | 30 | 43 |
| Grants and contributions | - | - | 311 | 238,461 | 311 | 238,461 |
| Other miscellaneous | 1,457 | 23,458 | 21,775 | - | 23,232 | 23,458 |
| Total Revenues | <u>357,564</u> | <u>360,691</u> | <u>816,607</u> | <u>1,074,561</u> | <u>1,174,171</u> | <u>1,435,252</u> |
| Expenses: | | | | | | |
| General government | 142,664 | 179,466 | - | - | 142,664 | 179,466 |
| Streets and drainage | 76,666 | 92,646 | - | - | 76,666 | 92,646 |
| Fire protection | 13,837 | 13,545 | - | - | 13,837 | 13,545 |
| Municipal court | 1,980 | 1,100 | - | - | 1,980 | 1,100 |
| Water, sewer, and sanitation | - | - | 588,325 | 635,940 | 588,325 | 635,940 |
| Depreciation | - | - | 222,181 | 227,062 | 222,181 | 227,062 |
| Interest on long-term debt | 6,959 | 20,499 | 482 | 885 | 7,441 | 21,384 |
| Total Expenses | <u>242,106</u> | <u>307,256</u> | <u>810,988</u> | <u>863,887</u> | <u>1,053,094</u> | <u>1,171,143</u> |
| Transfers In (Out) | 175,855 | 130,527 | (175,855) | (130,527) | - | - |
| Total Transfers | <u>175,855</u> | <u>130,527</u> | <u>(175,855)</u> | <u>(130,527)</u> | <u>-</u> | <u>-</u> |
| Change in net position | <u>291,313</u> | <u>183,962</u> | <u>(170,236)</u> | <u>80,147</u> | <u>121,077</u> | <u>264,109</u> |
| Net position at beginning of year | 566,972 | 391,561 | 2,629,616 | 2,599,768 | 3,196,588 | 2,991,329 |
| Prior period adjustment | - | (8,551) | - | (50,299) | - | (58,850) |
| Net position at end of year | <u>\$ 858,285</u> | <u>\$ 566,972</u> | <u>\$ 2,459,380</u> | <u>\$ 2,629,616</u> | <u>\$ 3,317,665</u> | <u>\$ 3,196,588</u> |

**CITY OF ELKHART, TEXAS
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

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

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

As of September 30, 2016, the City's governmental funds reported a total fund balance of \$551,688, of which \$64,439 is restricted for payment of debt service. During the year, the fund balance in the City's governmental funds increased by \$204,693.

General Fund Budget – A comparison of the general fund budget and actual results on page 14. For the current year, actual revenues were higher than budgeted amounts by \$29,456 while actual expenditures were less than budgeted amounts by \$16,061. For the current year, the general fund balance increased by \$140,453 during the fiscal year compared to the \$104,605 increase that was budgeted.

CAPITAL ASSETS

The City's investment in capital assets as of September 30, 2016, totaled \$3,205,587 (net accumulated depreciation). This investment includes land, buildings and improvements, streets and drainage, and equipment.

Current year expenditures during the current year included:

- Various water/sewer plant improvements and upgrades
- Sirens (grant funded and completed in current year)

| | Governmental Activities | | Business-Type Activities | | Total | |
|--------------------------------|-------------------------|-------------------|--------------------------|---------------------|---------------------|---------------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Land | \$ 2,350 | \$ 2,350 | \$ 61,203 | \$ 61,203 | \$ 63,553 | \$ 63,553 |
| Buildings and improvements | 100,770 | 106,928 | - | - | 100,770 | 106,928 |
| Plant and equipment | - | - | 2,158,231 | 2,299,593 | 2,158,231 | 2,299,593 |
| Machinery and equipment | 36,825 | 30,375 | 201,073 | 231,127 | 237,898 | 261,502 |
| Transportation equipment | - | - | 5,181 | 5,718 | 5,181 | 5,718 |
| Office equipment and furniture | 1,986 | 4,231 | 2,829 | 876 | 4,815 | 5,107 |
| Streets and drainage | 635,139 | 659,323 | - | - | 635,139 | 659,323 |
| Total Net Assets | <u>\$ 777,070</u> | <u>\$ 803,207</u> | <u>\$ 2,428,517</u> | <u>\$ 2,598,517</u> | <u>\$ 3,205,587</u> | <u>\$ 3,401,724</u> |

DEBT ADMINISTRATION

At the end of the current fiscal year, the City had total debt outstanding of \$572,965.

| | Governmental Activities | | Business-Type Activities | | Total | |
|---------------------------|-------------------------|-------------------|--------------------------|------------------|-------------------|-------------------|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Capital lease obligations | \$ 13,210 | \$ 19,011 | \$ 8,163 | \$ 21,855 | \$ 21,373 | \$ 40,866 |
| Net pension liability | 14,552 | 12,663 | 84,040 | 74,482 | 98,592 | 87,145 |
| Bonds payable | 453,000 | 560,000 | - | - | 453,000 | 560,000 |
| Total | <u>\$ 480,762</u> | <u>\$ 591,674</u> | <u>\$ 92,203</u> | <u>\$ 96,337</u> | <u>\$ 572,965</u> | <u>\$ 688,011</u> |

BASIC FINANCIAL STATEMENTS

EXHIBIT 1

CITY OF ELKHART, TEXAS
STATEMENT OF NET POSITION
SEPTEMBER 30, 2016

| | PRIMARY GOVERNMENT | | |
|---|-------------------------|--------------------------|---------------------|
| | GOVERNMENTAL ACTIVITIES | BUSINESS-TYPE ACTIVITIES | TOTAL |
| ASSETS | | | |
| Cash and cash equivalents | \$ 399,591 | \$ 198,307 | \$ 597,898 |
| Receivables | 43,145 | 72,805 | 115,950 |
| Inventory | - | 16,041 | 16,041 |
| Internal balances | 60,875 | (60,875) | - |
| Restricted assets | | | |
| Cash and cash equivalents | 65,716 | - | 65,716 |
| Capital assets | | | |
| Nondepreciable | 2,350 | 61,203 | 63,553 |
| Depreciable, net of accumulated depreciation | 774,720 | 2,367,314 | 3,142,034 |
| Total Assets | 1,346,397 | 2,654,795 | 4,001,192 |
| DEFERRED OUTFLOWS OF RESOURCES | | | |
| Deferred Outflows Related to TMRS Pension | 4,592 | 26,594 | 31,186 |
| Total Deferred Outflows of Resources | 4,592 | 26,594 | 31,186 |
| LIABILITIES | | | |
| Accounts payable | 11,942 | 14,909 | 26,851 |
| Customer deposits payable | - | 102,766 | 102,766 |
| Insurance proceeds refundable | - | 12,131 | 12,131 |
| Noncurrent liabilities: | | | |
| Due within one year | 115,094 | 8,163 | 123,257 |
| Due in more than one year | 351,116 | - | 351,116 |
| Net pension liability | 14,552 | 84,040 | 98,592 |
| Total Liabilities | 492,704 | 222,009 | 714,713 |
| NET POSITION | | | |
| Invested in capital assets, net of related debt | 310,860 | 2,420,354 | 2,731,214 |
| Restricted for: | | | |
| Debt service | 64,439 | - | 64,439 |
| Unrestricted | 482,986 | 39,026 | 522,012 |
| Total Net Position | \$ 858,285 | \$ 2,459,380 | \$ 3,317,665 |

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

EXHIBIT 2

CITY OF ELKHART, TEXAS
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED SEPTEMBER 30, 2016

| PROGRAM ACTIVITIES | PROGRAM REVENUES | | NET (EXPENSE) REVENUE AND CHANGES IN NET POSITION | | | |
|--------------------------------------|------------------|----------------------|---|--------------|-------------------------|--------------------------|
| | EXPENSES | CHARGES FOR SERVICES | CAPITAL GRANTS AND CONTRIBUTIONS | | PRIMARY GOVERNMENT | |
| | | | | | GOVERNMENTAL ACTIVITIES | BUSINESS-TYPE ACTIVITIES |
| PRIMARY GOVERNMENT: | | | | | | |
| Governmental activities: | | | | | | |
| General government | \$ 142,664 | \$ - | \$ - | \$ (142,664) | \$ - | \$ (142,664) |
| Streets | 76,666 | - | - | (76,666) | - | (76,666) |
| Fire protection | 13,837 | - | - | (13,837) | - | (13,837) |
| Municipal court | 1,980 | - | - | (1,980) | - | (1,980) |
| Interest on long-term debt | 6,959 | - | - | (6,959) | - | (6,959) |
| Total government activities | 242,106 | - | - | (242,106) | - | (242,106) |
| Business-type activities: | | | | | | |
| Water, sewer, and sanitation | 810,506 | 794,515 | 311 | - | (15,680) | (15,680) |
| Interest on long-term debt | 482 | - | - | - | (482) | (482) |
| Miscellaneous | - | - | - | - | - | - |
| Total business-type activities | 810,988 | 794,515 | 311 | - | (16,162) | (16,162) |
| Total primary government | 1,053,094 | 794,515 | 311 | (242,106) | (16,162) | (258,268) |
| General Revenues: | | | | | | |
| Property taxes | | | | 104,027 | - | 104,027 |
| Sales tax | | | | 169,477 | - | 169,477 |
| Franchise taxes | | | | 82,579 | - | 82,579 |
| Interest income | | | | 24 | 6 | 30 |
| Other revenue | | | | 1,457 | 21,775 | 23,232 |
| Transfers in (out) | | | | 175,855 | (175,855) | - |
| Total general revenues and transfers | | | | 533,419 | (154,074) | 379,345 |
| Change in net position | | | | 291,313 | (170,236) | 121,077 |
| Net position - beginning of year | | | | 566,972 | 2,629,616 | 3,196,588 |
| Net position - end of year | | | | \$ 858,285 | \$ 2,459,380 | \$ 3,317,665 |

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

CITY OF ELKHART, TEXAS
BALANCE SHEET
GOVERNMENTAL FUNDS
SEPTEMBER 30, 2016

| | GENERAL FUND | DEBT SERVICE | TOTAL |
|--|-------------------|------------------|-------------------|
| ASSETS | | | |
| Cash and cash equivalents | \$ 399,591 | \$ - | \$ 399,591 |
| Receivables | | | |
| Property taxes, net of allowance | 4,433 | - | 4,433 |
| Sales taxes | 27,990 | - | 27,990 |
| Other | 10,722 | - | 10,722 |
| Due from other funds | 60,959 | - | 60,959 |
| Restricted assets | | | |
| Cash and cash equivalents | - | 65,716 | 65,716 |
| Total Assets | <u>503,695</u> | <u>65,716</u> | <u>569,411</u> |
| LIABILITIES | | | |
| Accounts payable | 12,013 | - | 12,013 |
| Accrued interest | - | 1,193 | 1,193 |
| Due to other funds | - | 84 | 84 |
| Total Liabilities | <u>12,013</u> | <u>1,277</u> | <u>13,290</u> |
| DEFERRED INFLOWS OF RESOURCES | | | |
| Unavailable revenue - property taxes | 4,433 | - | 4,433 |
| Total deferred inflows of resources | <u>4,433</u> | <u>-</u> | <u>4,433</u> |
| FUND BALANCES | | | |
| Restricted for: | | | |
| Debt service | - | 64,439 | 64,439 |
| Unassigned | 487,249 | - | 487,249 |
| Total Fund Balances | <u>487,249</u> | <u>64,439</u> | <u>551,688</u> |
| Total Liabilities, Deferred Inflows of Resources, and Fund Balances | <u>\$ 503,695</u> | <u>\$ 65,716</u> | <u>\$ 569,411</u> |

CITY OF ELKHART, TEXAS
BALANCE SHEET
GOVERNMENTAL FUNDS
SEPTEMBER 30, 2016

Reconciliation of the governmental funds balance sheet to the statement of net position (Exhibit 1)

| | |
|--|-------------------|
| Total fund balances governmental funds (Exhibit 3 page 1) | \$ 551,688 |
| Capital assets used in governmental activities are not financial resources, and therefore, are not reported in the governmental funds balance sheet. | 777,070 |
| Other long-term assets are not available to pay for current period expenditures, and therefore, are deferred in the funds. | 4,433 |
| Recognition of the City's net pension liability and related deferred resource outflow occurs in the statement of net position but is not reported in the funds. | (9,960) |
| Long-term liabilities, including bonds payable and capital leases, are not due and payable in the current period, and therefore, are not reported in the governmental funds balance sheet. | (464,946) |
| Net position of governmental activities | <u>\$ 858,285</u> |

EXHIBIT 4

CITY OF ELKHART, TEXAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2016

| | GENERAL FUND | DEBT SERVICE FUND | TOTAL |
|---------------------------------------|-------------------|-------------------------|-------------------|
| REVENUES | | | |
| Property taxes, penalty and interest | \$ 103,948 | \$ - | \$ 103,948 |
| Sales taxes | 169,477 | - | 169,477 |
| Franchise taxes | 82,579 | - | 82,579 |
| Interest income | - | 24 | 24 |
| Other revenue | 1,457 | - | 1,457 |
| Total Revenues | <u>357,461</u> | <u>24</u> | <u>357,485</u> |
| EXPENDITURES | | | |
| General government | 130,737 | 4,715 | 135,452 |
| Fire protection | 10,657 | - | 10,657 |
| Streets | 43,894 | - | 43,894 |
| Municipal court | 1,980 | - | 1,980 |
| Capital outlay | 15,639 | - | 15,639 |
| Debt service | - | - | - |
| Principal retired | 5,801 | 107,000 | 112,801 |
| Interest | 1,131 | 7,093 | 8,224 |
| Total Expenditures | <u>209,839</u> | <u>118,808</u> | <u>328,647</u> |
| Revenues Over (Under) Expenditures | <u>147,622</u> | <u>(118,784)</u> | <u>28,838</u> |
| OTHER FINANCING SOURCES (USES) | | | |
| Transfers in (out) | <u>(7,169)</u> | <u>183,024</u> | <u>175,855</u> |
| Total Other Financing Sources (Uses) | <u>(7,169)</u> | <u>183,024</u> | <u>175,855</u> |
| Net Change in Fund Balances | 140,453 | 64,240 | 204,693 |
| Fund Balance, October 1, 2015 | <u>346,796</u> | <u>199</u> | <u>346,995</u> |
| Fund Balance, September 30, 2016 | <u>\$ 487,249</u> | <u>\$ 64,439</u> | <u>\$ 551,688</u> |

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

EXHIBIT 5

CITY OF ELKHART, TEXAS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED SEPTEMBER 30, 2015

Amounts reported for governmental activities in the statement of activities (Exhibit 2) are different because:

| | |
|--|--------------------------|
| Net changes in fund balances - total governmental funds | \$ 204,693 |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlay in the current period. | (26,136) |
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. | 79 |
| The issuance of long-term debt (e.g., bonds, leases, certificates of obligation) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net position. Also, governmental funds report the effect of premiums, discounts, and similar items when debt is first issued, whereas, these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items. | 114,065 |
| Changes in GASB 68 pension expense due to changes in the current period deferred outflow of resources and the deferred inflow of resources. | <u>(1,388)</u> |
| Change in net position of governmental activities | <u><u>\$ 291,313</u></u> |

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

CITY OF ELKHART, TEXAS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
GENERAL FUND
FISCAL YEAR ENDED SEPTEMBER 30, 2016

| | <u>Original Appropriated Budget</u> | <u>Final Appropriated Budget</u> | <u>Actual Amounts</u> | <u>Variances Favorable (Unfavorable)</u> |
|--|---|--|---------------------------|--|
| REVENUES | | | | |
| Property taxes, penalty and interest | \$ 106,565 | \$ 106,565 | \$ 103,948 | \$ (2,617) |
| Sales taxes | 135,000 | 135,000 | 169,477 | 34,477 |
| Franchise taxes | 85,000 | 85,000 | 82,579 | (2,421) |
| Other revenues | 1,440 | 1,440 | 1,457 | 17 |
| Total Revenues | <u>328,005</u> | <u>328,005</u> | <u>357,461</u> | <u>29,456</u> |
| EXPENDITURES | | | | |
| General government | 136,500 | 136,500 | 130,737 | 5,763 |
| Fire protection | - | - | 10,657 | (10,657) |
| Streets | 47,400 | 47,400 | 43,894 | 3,506 |
| Municipal court | - | - | 1,980 | (1,980) |
| Capital outlay | 42,000 | 42,000 | 15,639 | 26,361 |
| Debt service | | | | |
| Principal retired | - | - | 5,801 | (5,801) |
| Interest | - | - | 1,131 | (1,131) |
| Total Expenditures | <u>225,900</u> | <u>225,900</u> | <u>209,839</u> | <u>16,061</u> |
| Revenues Over (Under) Expenditures | <u>102,105</u> | <u>102,105</u> | <u>147,622</u> | <u>45,517</u> |
| OTHER FINANCING SOURCES (USES) | | | | |
| Transfers in (out) | <u>2,500</u> | <u>2,500</u> | <u>(7,169)</u> | <u>(9,669)</u> |
| Total Other Financing Sources (Uses) | <u>2,500</u> | <u>2,500</u> | <u>(7,169)</u> | <u>(9,669)</u> |
| Revenues and Other Sources Over (Under) Expenditures and Other Uses | <u>104,605</u> | <u>104,605</u> | <u>140,453</u> | <u>35,848</u> |
| Fund Balance, October 1, 2015 | <u>346,796</u> | <u>346,796</u> | <u>346,796</u> | <u>-</u> |
| Fund Balance, September 30, 2016 | <u>\$ 451,401</u> | <u>\$ 451,401</u> | <u>\$ 487,249</u> | <u>\$ 35,848</u> |

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

**CITY OF ELKHART, TEXAS
STATEMENT OF NET POSITION
PROPRIETARY FUNDS
SEPTEMBER 30, 2016**

| | <u>UTILITY</u> | <u>PROPRIETARY GRANT FUND</u> | <u>TOTAL</u> |
|---|---------------------|-----------------------------------|---------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 198,307 | \$ - | \$ 198,307 |
| Receivables, net of allowance | 61,856 | - | 61,856 |
| Unbilled receivables | 10,949 | - | 10,949 |
| Inventory | 16,041 | - | 16,041 |
| Total Current Assets | <u>287,153</u> | <u>-</u> | <u>287,153</u> |
| Noncurrent assets: | | | |
| Capital assets | | | |
| Nondepreciable | 61,203 | - | 61,203 |
| Depreciable, net of accumulated depreciation | 2,367,314 | - | 2,367,314 |
| Total Noncurrent Assets | <u>2,428,517</u> | <u>-</u> | <u>2,428,517</u> |
| Total Assets | <u>2,715,670</u> | <u>-</u> | <u>2,715,670</u> |
| DEFERRED OUTFLOWS OF RESOURCES | | | |
| Deferred Outflows Related to TMRS Pension | 26,594 | - | 26,594 |
| Total Deferred Outflows of Resources | <u>26,594</u> | <u>-</u> | <u>26,594</u> |
| LIABILITIES | | | |
| Current liabilities: | | | |
| Accounts payable | 14,909 | - | 14,909 |
| Customer deposits payable | 102,766 | - | 102,766 |
| Due to other funds | 60,875 | - | 60,875 |
| Insurance proceeds refundable | 12,131 | - | 12,131 |
| Capital leases - current maturities | 8,163 | - | 8,163 |
| Total Current Liabilities | <u>198,844</u> | <u>-</u> | <u>198,844</u> |
| Noncurrent liabilities: | | | |
| Net pension liability | 84,040 | - | 84,040 |
| Total Noncurrent Liabilities | <u>84,040</u> | <u>-</u> | <u>84,040</u> |
| Total Liabilities | <u>282,884</u> | <u>-</u> | <u>282,884</u> |
| NET POSITION | | | |
| Invested in capital assets, net of related debt | 2,420,354 | - | 2,420,354 |
| Unrestricted | 39,026 | - | 39,026 |
| Total Net Position | <u>\$ 2,459,380</u> | <u>\$ -</u> | <u>\$ 2,459,380</u> |

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

EXHIBIT 8

CITY OF ELKHART, TEXAS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
PROPRIETARY FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2016

| | UTILITY FUND | PROPRIETARY GRANT FUND | TOTAL |
|--|---------------------|---------------------------|---------------------|
| OPERATING REVENUES | | | |
| Water sales | \$ 396,427 | \$ - | \$ 396,427 |
| Sewer income | 210,683 | - | 210,683 |
| Garbage income | 158,919 | - | 158,919 |
| Late charges and other income | 28,386 | - | 28,486 |
| Total Operating Revenues | <u>794,415</u> | <u>-</u> | <u>794,515</u> |
| OPERATING EXPENSES | | | |
| Personnel and related costs | 286,790 | - | 286,790 |
| Supplies and materials | 36,943 | - | 36,943 |
| Repairs and maintenance | 12,095 | - | 12,095 |
| Garbage expense | 146,434 | - | 146,434 |
| Professional fees | 37,951 | - | 37,951 |
| Insurance | 133 | - | 133 |
| Utilities | 46,723 | - | 46,723 |
| Office expense | 5,695 | - | 5,695 |
| Other expense | 15,561 | - | 15,561 |
| Depreciation | 222,181 | - | 222,181 |
| Total Operating Expenses | <u>810,506</u> | <u>-</u> | <u>810,506</u> |
| Operating Income (Loss) | <u>(16,091)</u> | <u>-</u> | <u>(15,991)</u> |
| NON-OPERATING REVENUES (EXPENSES) | | | |
| Grant revenues | 311 | - | 311 |
| Interest income | 6 | - | 6 |
| Interest expense | (482) | - | (482) |
| Insurance reimbursement | 21,775 | - | 21,775 |
| Total Nonoperating Revenues (Expenses) | <u>21,610</u> | <u>-</u> | <u>21,610</u> |
| INCOME BEFORE TRANSFERS | <u>5,519</u> | <u>-</u> | <u>5,619</u> |
| Transfers in (out) | <u>(175,755)</u> | <u>(100)</u> | <u>(175,855)</u> |
| Change in Net Position | <u>(170,236)</u> | <u>(100)</u> | <u>(170,236)</u> |
| Net Position, October 1, 2015 | <u>2,629,616</u> | <u>100</u> | <u>2,629,616</u> |
| Net Position, September 30, 2016 | <u>\$ 2,459,380</u> | <u>\$ -</u> | <u>\$ 2,459,380</u> |

EXHIBIT 9

**CITY OF ELKHART, TEXAS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

CASH FLOWS FROM OPERATING ACTIVITIES:

| | |
|---|----------------|
| Cash received from customers and users | \$ 835,559 |
| Cash payments to suppliers | (299,804) |
| Cash payments to employees | (279,770) |
| Net Cash Provided by Operating Activities | <u>255,985</u> |

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:

| | |
|--|------------------|
| Net advances from other funds | 826 |
| Operating transfers out | (175,855) |
| Net Cash (Used) by Noncapital Financing Activities | <u>(175,029)</u> |

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

| | |
|---|-----------------|
| Acquisition of capital assets | (52,181) |
| Grant expenses | (16,322) |
| Proceeds from insurance settlements | 21,775 |
| Principal payments on long-term debt | (13,692) |
| Interest payments on long-term debt | (482) |
| Net Cash (Used) by Capital and Related Financing Activities | <u>(60,902)</u> |

CASH FLOWS FROM INVESTING ACTIVITIES:

| | |
|---|----------|
| Interest received | <u>6</u> |
| Net Cash Provided by Investing Activities | <u>6</u> |

Net Decrease in Cash and Cash Equivalents 20,060

Cash and Cash Equivalents at Beginning of Year 178,247

Cash and Cash Equivalents at End of Year \$ 198,307

Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:

| | |
|---|--------------------------|
| Operating income (loss) | \$ (15,991) |
| Adjustments to reconcile operating loss to net cash provided by operating activities: | |
| Depreciation and amortization | 222,181 |
| Changes in assets and liabilities: | |
| (Increase) decrease in accounts receivable | 35,010 |
| Increase (decrease) in accounts payable | (3,344) |
| Increase (decrease) in deferred outflows related to pensions | 2,537 |
| Increase (decrease) in net pension obligation | 9,558 |
| Increase (decrease) in customer deposits payable | <u>6,034</u> |
| Total Adjustments | <u>271,976</u> |
| Net Cash Provided by Operating Activities | <u><u>\$ 255,985</u></u> |

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

**CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General Statement

The City of Elkhart ("The City") is a political subdivision and a municipal corporation organized and existing under the general laws of the State of Texas. The City operates under a Mayor-Council form of government.

The financial statements of the City have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") as applied to government units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant accounting and reporting policies used by the City are discussed below.

The City provides the following services: General government, public works, and water, sewer, and sanitation utilities.

B. Reporting Entity

These financial statements present all of the funds of the City.

For financial reporting purposes, based on standards established by GASB Statement No. 61, The Financial Reporting Entity: Omnibus, these financial statements should present the City (the primary government) and its component units. Component units generally are legally separate entities for which the primary government is financially accountable or for which the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading. The City does not have any blended or discretely presented component units.

C. Government-Wide Financial Statements

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: 1) charges to customers 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 revenue sources not properly included with program revenues are reported as general revenues. Major individual governmental funds are reported as separate columns in the financial statements.

D. Basis of Presentation - Government-Wide Financial Statements

While separate government-wide and fund financial statements are presented, they are interrelated. The governmental activities column incorporates data from governmental funds, while business-type activities incorporate data from the City's proprietary fund. Separate financial statements are provided for governmental funds and the proprietary fund.

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

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

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

The government-wide statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property tax revenues are recognized in the year for which they are levied. Grants and donations are recognized as revenue in the fiscal year in which grantor eligibility requirements have been satisfied.

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. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The City considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are recorded when the related liability is incurred, as under accrual accounting. However, debt service expenditures, both principal and interest, are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Issuance of long-term debt and acquisitions under capital leases are reported as other financing sources.

Property taxes, sales taxes, franchise taxes, and interest associated with the current fiscal year are all considered to be susceptible to accrual and have been recognized as revenues of the current fiscal period. Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements, and the amount is received during the period or within the availability period for this revenue source (within 60 days of the year end). Expenditure driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other grant requirements have been met. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following governmental funds:

The *general fund* is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. The principal sources of revenue include local property taxes, fees, licenses and permits, and sales and franchise taxes. Expenditures include general government, streets, fire, municipal court, and health and welfare. The general fund is always considered a major fund for reporting purposes.

The *debt service fund* is used to account for the accumulation of restricted monies for the payment of general obligation debt. The primary source of revenue for debt service is local sales taxes.

The City reports the following major proprietary fund:

The *utility fund* is used to account for the operation of the water, sewer, and sanitation systems that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The fund also accounts for the accumulation of resources for, and the payment of, long-term debt.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating income reported in proprietary fund financial statements include revenues and expenses related to the primary, continuing operations of the fund. Principal operating revenues for proprietary funds are charges to customers for sales or services. Principal operating expenses are the costs of providing goods or services and include administrative expense and depreciation of capital assets. Revenues and expenses not meeting this definition are classified as non-operating in the financial statements.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

E. Measurement Focus, Basis of Accounting, and Financial Statement Presentation - Continued

All expenses incurred by the City are properly segregated and accounted for in the fund to which the expenses apply. Certain general and administrative expenses are allocated to the proprietary fund and to the governmental fund based on the level of services rendered through each fund as estimated by management.

F. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance

1. Cash and Cash Equivalents

The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. For purposes of the statement of cash flows, the proprietary fund considers temporary investments with a maturity of three months or less when purchased to be cash equivalents.

2. Fair Value of Financial Instruments

The City evaluates the fair value of its non-investment financial instruments based on the current interest rate environment and current pricing of debt instruments with comparable terms. The carrying value of all non-investment financial instruments, including debt, is considered "fair value."

3. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. current position of interfund loans) or "advances to/from other funds" (i.e. the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances". While these balances are reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Balances between the funds included in governmental activities are eliminated so that only the net amount is included as internal balances in the governmental activities column. Similarly, balance between the funds included in business-type activities are eliminated so that only the net amount is included as internal balances in the business-type activities column.

All receivables are shown net of an allowance for uncollectible. The City provides an allowance for doubtful accounts based upon the anticipated collectability of each specific account, as determined by experience.

4. Restricted Assets

Certain assets are classified as restricted because they are maintained in separate accounts and their use is limited by applicable bond covenants, grant agreements, laws or regulations, and/or other contractual agreements.

5. Inventories

Inventories are valued at cost which approximates market, using the first-in/first-out method. Inventories consist of expendable supplies and repair parts held for consumption. The cost of inventory is recorded as an expenditure when used (consumption method).

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

F. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance - Continued

6. Capital Assets

Capital assets, which include land, buildings and improvements, furniture and equipment, and infrastructure assets, are reported in the applicable governmental or business-type activities column in the government-wide financial statements. In accordance with GASB Statement No. 34, infrastructure has been capitalized retroactively. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Contributed capital assets are recorded at estimated fair market value at the date received.

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.

Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in operations.

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

| <u>Asset Description</u> | <u>Estimated Useful Life</u> |
|----------------------------------|------------------------------|
| Buildings and improvements | 20-50 years |
| Utility plant and equipment | 7-40 years |
| Machinery and equipment | 5-20 years |
| Transportation equipment | 5 years |
| Office, furniture, and equipment | 5-10 years |
| Streets and drainage | 10 years |

7. Compensated Absences

Employees of the City are entitled to paid vacation and sick days, depending on length of service.

The City's policy is for employees to take their vacation within the City's fiscal year. If not used within the time frame allotted, the vacation time is forfeited. Under certain Council-approved circumstances, employees are allowed to carry over vacation time balances. No accrual is made to record year-end vacation time carried over in this financial statement because the amount is immaterial.

Employee sick leave time may be carried over from one year to the next, but no cash payment for accumulated sick leave is made when an employee separates from the City, whatever the reason. The City's policy is to pay for, and expense, sick leave as it is taken.

8. Long-Term Obligations

In the government-wide financial statements and proprietary fund type in the fund financial statement, long-term and other long-term obligations are reported as liabilities in the applicable governmental activities or business-type activities Statement of Net Position.

Both premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method, if material. Bonds payable are reported net of applicable bond premium or discount.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

F. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance - Continued

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

Assets acquired under the terms of a capital lease are recorded as liabilities and capitalized in the government-wide financial statements at the present value of net minimum lease payments at inception of the lease. In the year of acquisition, capital lease transactions are recorded as other financing sources and as capital outlay expenditures in the applicable fund. Lease payments representing both principal and interest are recorded as expenditures in the general fund upon payment with an appropriate reduction of principal recorded in the government-wide financial statements.

9. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) until then. The City has a deferred charge on the TMRS pension. The TMRS pension expense and net pension liability are reported as of the date of the last actuarial study, which was December 31, 2015. The deferred outflow shows the difference in contributions to the TMRS retirement plan that occurred between December 31, 2015 and September 30, 2016.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The City has two items that qualify for reporting in this category. *Unavailable revenue* is reported only in the governmental funds balance sheet. The governmental funds report unavailable revenues from property taxes. This amount is deferred and recognized as an inflow of resources in the period that the amount becomes available. The second is reported in the government-wide statement of net position. It is a deferred charge related to the TMRS retirement pension. This represents the differences between expected and actual actuarial gains and losses and projected and actual pension plan investment gains and losses. This amount will be amortized in future periods.

10. Pensions

For the year ended September 30, 2016, the City followed the provisions of GASB Statement 68, Accounting and Financial Reporting for Pensions, as amended by GASB Statement 71, Pension Transition for Contributions Made Subsequent to the Measurement Date. The fiduciary net position of the Texas Municipal Retirement System of Texas (TMRS) has been determined based on the flow of economic resource measurement focus and full accrual basis of accounting. This includes, for purposes, of measuring the net pension liability: deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, and information about assets, and liabilities and additions to/deductions from TMRS's fiduciary net position. Benefit payments (including refunds of employee contributions) are recognized when due and payable, in accordance with the benefit terms. Investments are reported at fair value.

11. Fund Balances Classification

In the fund financial statements, governmental funds report fund balance categorized as non-spendable, restricted, committed, assigned, or unassigned. Fund balances are classified as follows:

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

F. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance - Continued

Non-spendable – amounts that cannot be spent either because they are in non-spendable form (such as inventories and prepaid amounts) or because they are legally or contractually required to be maintained intact.

Restricted – amounts that can be spent only for specific purposes due to constraints imposed on resources either (a) externally by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or (b) imposed by law through constitutional provisions or enabling legislation.

Committed – amounts that can only be used for specific purposes pursuant to constraints imposed by formal resolutions or ordinances of the Council – the government's highest level of decision making authority. Commitments may be established, modified, or rescinded only through ordinances or resolutions approved by the Council.

Assigned – amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes.

Unassigned – all other spendable amounts.

When more than one classification of fund balance is available for use, it is the City's policy to use the most restricted resources first.

12. Net Position

The City has adopted GASB Statement No. 63, which redefines how net assets are presented in the financial statements. The Statement of Net Assets is now the Statement of Net Position. Net position represents the difference between the assets and liabilities and is now divided into three components.

Net investment in capital assets – This component consists of the City's capital assets, net of accumulated depreciation, reduced by any outstanding debt used for the acquisition or construction of those assets and adjusted for any deferred outflows and inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt.

Restricted – This component consists of those amounts which have limitations imposed on their use either through legislation adopted by the City or through external restrictions imposed by creditors, grantors, or other laws and regulations, reduced by liabilities and deferred inflows of resources related to those assets.

Unrestricted – This component consists of the net amount of the assets, deferred outflows and inflows of resources, and liabilities not included in net investment in capital assets or restricted components of net position.

13. Estimates

The preparation of financial statements, in conformity with the generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

NOTE 2: 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 Position

An element of that reconciliation states that "Capital assets used in governmental activities are not current financial resources, and therefore, are not reported in the governmental funds balance sheet." The details of this \$777,070 difference are as follows:

| | |
|---|-------------------|
| Capital assets, October 1, 2015, net of accumulated depreciation | \$ 803,207 |
| Capital asset additions, net of retirements | 15,639 |
| Depreciation of capital assets, net of retirements | (41,776) |
| Net adjustment to increase total fund balances - total governmental funds to arrive at net position - governmental activities | <u>\$ 777,070</u> |

Another element of the reconciliation states that "Recognition of the City's net pension liability and related deferred resource outflow occurs in the statement of net position but is not reported in the funds." The details of this \$(9,960) difference are as follows:

| | |
|---|-------------------|
| Net pension liabilities | \$ (14,552) |
| Deferred resource outflow | 4,592 |
| Net adjustment to decrease total fund balances - total governmental funds to arrive at net position - governmental activities | <u>\$ (9,960)</u> |

The reconciliation states that "Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds." The details of this \$(464,949) difference are as follows:

| | |
|---|---------------------|
| General obligation bonds payable | \$ (453,000) |
| Capital lease payable | (13,210) |
| Change in accrued interest | 1,264 |
| Net adjustment to decrease total fund balances - total governmental funds to arrive at net position - governmental activities | <u>\$ (464,946)</u> |

B. Explanation of Certain Differences Between the Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance and the Government-Wide Statement of Activities

An element of that reconciliation explains that "Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlay in the current period." The details of this \$(26,136) difference are as follows:

| | |
|---|--------------------|
| Capital outlay expenditures | \$ 15,639 |
| Depreciation expense | (41,776) |
| Rounding | 1 |
| Net adjustment to decrease net changes in fund balances - total governmental funds to arrive at changes in net position - governmental activities | <u>\$ (26,136)</u> |

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

B. Explanation of Certain Differences Between the Governmental Fund Statement of Revenue, Expenditures, and Changes in Fund Balance and the Government-Wide Statement of Activities - Continued

Another element of the reconciliation states that "The issuance of long-term debt (e.g. bonds, leases, certificates of obligation) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net position. Also, governmental funds report the effect of premiums, discounts, and similar items when debt is first issued, whereas, these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items." The details of this \$114,065 difference are as follows:

| | |
|---|-------------------|
| Principal payments on debt | \$ 112,801 |
| Change in accrued interest | 1,264 |
| Net adjustment to increase net changes in fund balances - total governmental funds to arrive at changes in net position - governmental activities | <u>\$ 114,065</u> |

NOTE 3: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

A. Budgets and Budgetary Process

In accordance with the City's legal requirements, the City adopts an annual budget for the general fund. Budgeted expenditures for the current year, as adopted in the original budget, may be amended to take into account special authorizations of the City Council during the year. All appropriations lapse at the end of each fiscal year. No amendments were made to the City's original budget during the current fiscal year.

B. Restricted Balances

Bond covenants and other contractual provisions require that the City establish separate bank accounts, with minimum balance requirements, for certain bond debt service and grant related capital expenditures. The City maintained the minimum balance requirements in these accounts at all times during the year and all debt service expenditures were made timely.

NOTE 4: DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

Cash and investments as of September 30, 2016 consist of and are classified in the accompanying financial statements as follows:

| | |
|--------------------------------------|-------------------|
| Statement of net position: | |
| Primary Government | |
| Cash and cash equivalents | \$ 597,898 |
| Restricted cash and cash equivalents | <u>65,716</u> |
| Total cash and cash equivalents | <u>\$ 663,614</u> |
| Cash on hand | \$ 202 |
| Savings and checking accounts | <u>663,412</u> |
| Total cash and investments | <u>\$ 663,614</u> |

**CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

A. Deposits and Investments - Continued

At September 30, 2016, the carrying amount of the City's deposits with financial institutions was \$663,614 and the bank balance was \$675,842. The bank balance was fully covered by federal depository insurance or collateral held by pledging financial institution's agent in the City's name.

Certificates of deposit consist of deposits with maturities greater than three months. Certificates of deposit are recorded at cost, which approximates market value. The City did not own any certificates of deposit at year end or at any time during the year.

The City is required by the Public Funds Collateral Act (Government Code, Chapter 2257) to maintain security for all deposits of funds that exceed coverage provided by the Federal Deposit Insurance Corporation (FDIC). As of the balance sheet date, the City's cash deposits were fully collateralized by securities pledged by the depository banks. Based on audit procedures conducted in conjunction with the audit of the basic financial statements, the City complied with the requirements of the Public Funds Collateral Act.

The City is required by the Public Funds Investment Act (Government Code, Chapter 2256) (the "Act") to adopt, implement, and publicize a written investment policy which primarily emphasizes safety of principal and liquidity, and addresses investment diversification, yield, and maturity. Additionally, the policy must address the quality and capability of investment management and include the types of investments in which the entity may invest its funds, as well as the maximum allowable stated maturity of any individual investment, the maximum dollar-weighted average maturity allowed based on the stated maturity date for the portfolio of pooled fund groups, and bid requirements for certificates of deposit.

The City is authorized to invest in financial instruments, as authorized by the Act, including:

- U.S. Treasury securities which have a liquid market; direct obligations of the State of Texas, and other obligations that are guaranteed by the State of Texas or United States of America;
- Obligations of states, agencies, counties, and other political subdivisions of any state having been rated as investment quality by a nationally recognized investment rating firm and having received a rating of not less than "A" or its equivalent;
- Fully insured or collateralized certificates of deposit at commercial banks;
- Repurchase agreements collateralized by U.S. Treasury or U.S. Government Agency securities in accordance with a master repurchase agreement;
- Joint pools of political subdivisions in the State of Texas which invest in instruments and follow practices allowed by current law (the pool must be continuously rated no lower than "AAA" or "AAA-m" by at least one nationally recognized rating service).

The Act also requires an annual audit of investment practices. The City did not have any investments at year end or any time during the current fiscal year.

Interest Rate Risk – In accordance with its investment policy, the City manages its exposure to declines in fair value by diversifying investments in terms of maturity. As of September 30, 2016, the City did not have any investments.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

A. Deposits and Investments - Continued

Credit Risk – State law and the City's investment policy limit investments to obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent. As of September 30, 2016, the City did not have any investments.

Custodial Credit Risk – Deposits. In the case of deposits, this is the risk that in the event of a bank failure, City's deposits may not be returned. The City's investment policy requires funds on deposit at depository banks to be collateralized to the extent that the deposits exceed FDIC coverage.

B. Elkhart Volunteer Fire Department ("EVFD") Donations

The City receives donations for the EVFD, generally through utility collections. These donations are transacted through a separate cash account and remitted to the EVFD on a periodic basis. Both the cash and offsetting liability are excluded from these financial statements. At September 30, 2016, the balance of collections to be remitted to the EVFD totaled \$162.

C. Receivables

The City's receivables at year end, including the related allowances for uncollectible accounts, are as follows:

| | <u>General Fund</u> | <u>Utility Fund</u> | <u>Total</u> |
|------------------------------------|-------------------------|-------------------------|-------------------|
| Receivables: | | | |
| Accounts | \$ - | \$ 88,281 | \$ 88,281 |
| Property taxes | 19,638 | - | 19,638 |
| Sales tax | 25,018 | - | 25,018 |
| Miscellaneous | 13,694 | - | 13,694 |
| Gross receivables | <u>58,350</u> | <u>88,281</u> | <u>146,631</u> |
| Less: Allowance for uncollectables | <u>(15,205)</u> | <u>(15,476)</u> | <u>(30,681)</u> |
| Net Receivables | <u>\$ 43,145</u> | <u>\$ 72,805</u> | <u>\$ 115,950</u> |

Property Taxes. Property taxes are levied on October 1 on the assessed value listed as of the prior January 1 for all real and business personal property located in the City. Taxes are due upon 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 taxes are considered available when paid.

The property tax rate to finance general governmental services for the year ended September 30, 2016, was \$.2945 per \$100 of assessed valuation. The total taxable value and total tax levy assessed for the year was \$35,130,387 and \$100,421, respectively. The City has contracted with the Anderson County Central Appraisal District for the collection of property taxes.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

D. Capital Assets

A summary of changes in governmental capital assets for the year ended September 30, 2016 was as follows:

| <u>PRIMARY GOVERNMENT</u> | <u>BEGINNING BALANCE</u> | <u>INCREASES</u> | <u>DECREASES</u> | <u>ENDING BALANCE</u> |
|---|------------------------------|------------------|------------------|---------------------------|
| Governmental Activities: | | | | |
| Capital Assets, Not Being Depreciated: | | | | |
| Land | \$ 2,350 | \$ - | \$ - | \$ 2,350 |
| Total Capital Assets, Not Being Depreciated | 2,350 | - | - | 2,350 |
| Capital Assets, Being Depreciated | | | | |
| Buildings and Improvements | 138,597 | - | - | 138,597 |
| Machinery and Equipment | 49,140 | 11,996 | - | 61,136 |
| Infrastructure | 17,329 | - | - | 17,329 |
| Streets | 842,153 | 3,643 | - | 845,796 |
| Total Capital Assets, Being Depreciated | 1,047,219 | 15,639 | - | 1,062,858 |
| Less Accumulated Depreciation For: | | | | |
| Buildings and Improvements | (31,669) | (6,158) | - | (37,827) |
| Machinery and Equipment | (18,765) | (5,546) | - | (24,311) |
| Infrastructure | (13,098) | (2,245) | - | (15,343) |
| Streets | (182,830) | (27,827) | - | (210,657) |
| Total Accumulated Depreciation | (246,362) | (41,776) | - | (288,138) |
| Net Total Assets Being Depreciated | 800,857 | (26,137) | - | 774,720 |
| Governmental Activities Capital Assets, Net | \$ 803,207 | \$ (26,137) | \$ - | \$ 777,070 |

Depreciation expense was charged to the following functions/programs of governmental activities as follows:

| | |
|--------------------|------------------|
| General government | \$ 5,823 |
| Fire protection | 3,180 |
| Streets | 32,773 |
| Total | <u>\$ 41,776</u> |

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

D. Capital Assets - Continued

A summary of changes in business-type capital assets for the year ended September 30, 2016 is as follows:

| <u>PRIMARY GOVERNMENT</u> | <u>BEGINNING BALANCE</u> | <u>INCREASES</u> | <u>DECREASES</u> | <u>ENDING BALANCE</u> |
|---|------------------------------|------------------|------------------|---------------------------|
| Business-Type Activities: | | | | |
| Capital Assets, Not Being Depreciated: | | | | |
| Land | \$ 61,203 | \$ - | \$ - | \$ 61,203 |
| Total Capital Assets, Not Being Depreciated | 61,203 | - | - | 61,203 |
| Capital Assets, Being Depreciated | | | | |
| Plant and Equipment | 5,098,858 | 47,143 | - | 5,146,001 |
| Machinery and Equipment | 434,128 | 2,335 | - | 436,463 |
| Office Equipment | 7,586 | 2,703 | - | 10,289 |
| Transportation Equipment | 76,533 | - | (8,213) | 68,320 |
| Total Capital Assets, Being Depreciated | 5,617,105 | 52,181 | (8,213) | 5,661,073 |
| Less Accumulated Depreciation For: | | | | |
| Plant and Equipment | (2,799,266) | (188,504) | - | (2,987,770) |
| Machinery and Equipment | (203,000) | (32,390) | - | (235,390) |
| Office Equipment | (6,710) | (750) | - | (7,460) |
| Transportation Equipment | (70,815) | (537) | 8,213 | (63,139) |
| Total Accumulated Depreciation | (3,079,791) | (222,181) | 8,213 | (3,293,759) |
| Net Total Assets Being Depreciated | 2,537,314 | (170,000) | - | 2,367,314 |
| Business-Type Activities Capital Assets, Net | \$ 2,598,517 | \$ (170,000) | \$ - | \$ 2,428,517 |

Depreciation expense of \$222,181 was charged to the utility fund.

E. Interfund Receivables, Payables, and Transfers

The following interfund receivable and payable balances are the result of cash needed by the utility fund until the fund is able to generate sufficient revenues to cover expenditures. These receivables and payables are netted and eliminated on the government-wide statement of net assets.

At September 30, 2016, these internal balances consisted of the following:

| | <u>Receivable</u> | <u>Payable</u> | <u>Net Totals</u> |
|---------------------------------|-------------------|----------------|-------------------|
| Governmental Activities | | | |
| General Fund | \$ 60,959 | \$ - | \$ 60,959 |
| Debt Service Fund | - | (84) | (84) |
| Total Governmental Activities | \$ 60,959 | \$ (84) | \$ 60,875 |
| Business-Type Activities | | | |
| Utility Fund | \$ - | \$ (60,875) | \$ (60,875) |
| Total Business-Type Activities | \$ - | \$ (60,875) | \$ (60,875) |

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

E. Interfund Receivables, Payables, and Transfers - Continued

Interfund transfers are indicative of re-allocation of revenues between funds with no anticipation of repayment.

The composition of interfund transfers as of September 30, 2016 was as follows:

| | Transfers In | | |
|------------------------|------------------|-------------------|-------------------|
| | General Fund | Debt Service Fund | Total |
| <u>Transfers Out:</u> | | | |
| Water and Sewer Fund | \$ 10,081 | \$ 165,774 | \$ 175,855 |
| Total transfers out/in | <u>\$ 10,081</u> | <u>\$ 165,774</u> | <u>\$ 175,855</u> |

F. Capital Leases

The City has entered into lease agreements as lessee for financing the acquisition of machinery and equipment. These lease agreements qualify as a capital lease for accounting purposes, and therefore, has been recorded at the present value of its future minimum lease payments as of the inception date.

The assets acquired through a capital leases are as follows:

| | Utility Fund | General Fund |
|--------------------------------|------------------|-----------------|
| Machinery and equipment | \$ 70,703 | \$ 27,310 |
| Less: accumulated depreciation | (25,532) | (20,025) |
| Total | <u>\$ 45,171</u> | <u>\$ 7,285</u> |

The future minimum lease obligations and the net present value of these minimum lease payments as of September 30, 2016, were as follows:

| Year ending September 30 | Utility Fund | General Fund | Total |
|---|--------------|--------------|------------------|
| 2017 | \$ 8,246 | \$ 5,945 | \$ 14,191 |
| 2018 | - | 6,399 | 6,399 |
| 2019 | - | 2,133 | 2,133 |
| | | | <u>22,723</u> |
| Total minimum lease payments | | | 22,723 |
| Less: amount representing interest | | | (1,350) |
| Present value of minimum lease payments | | | <u>\$ 21,373</u> |

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

G. Long-Term Debt

The following is a summary of bond and certificates of obligation transactions of the City for the year ended September 30, 2016:

| | <u>GENERAL OBLIGATION</u> |
|------------------------------------|-------------------------------|
| Bonds payable - October 1, 2015 | \$ 560,000 |
| Additions | - |
| Retirements | <u>(107,000)</u> |
| Bonds payable - September 30, 2016 | <u>\$ 453,000</u> |

Original issue amounts currently outstanding are as follows:

| <u>Purpose</u> | <u>Interest Rates</u> | <u>Original Issue Amount</u> |
|--|---------------------------|----------------------------------|
| Governmental Activities: | | |
| 2014 CNH Industrial Capital Lease | 6.89% | \$ 27,310 |
| 2015 General Obligation Refunding Bonds | 2.10% | <u>560,000</u> |
| Total Governmental Activities Long-Term Debt | | <u>\$ 587,310</u> |
| Business-Type Activities: | | |
| 2012 Welch State Bank Capital Lease | 3.03% | <u>\$ 65,667</u> |
| Total Business-Type Activities Long-Term Debt | | <u>\$ 65,667</u> |

Annual debt service requirements to maturity for the City for general obligations bonds are as follows:

| <u>Year Ending September 30</u> | <u>Governmental Activities</u> | | |
|-------------------------------------|--------------------------------|------------------|-------------------|
| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
| 2017 | \$ 110,000 | \$ 8,386 | \$ 118,386 |
| 2018 | 112,000 | 6,047 | 118,047 |
| 2019 | 114,000 | 3,666 | 117,666 |
| 2020 | 117,000 | 1,233 | 118,233 |
| Total | <u>\$ 453,000</u> | <u>\$ 19,332</u> | <u>\$ 472,332</u> |

General obligation bonds are direct obligations of the City for which its full faith and credit are pledged. The bond indenture allows the City to pay the bonds from the proceeds of an additional ad valorem tax that may be levied by the City, and the City has pledged any such proceeds to secure the payment. However, the City Council has elected to repay the bonds from the City's proprietary fund revenues.

Bond Compliance Requirements. The bond ordinances require that during the period in which the bonds are outstanding, the City must create and maintain certain accounts or funds to receive the proceeds from the sale of the bonds and to account for the revenues (as defined) and/or taxes, which are pledged for payment of the bonds. The assets can be used only in accordance with the terms of the bond ordinance and for the specific purpose(s) designated therein.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

G. Long-Term Debt - Continued

Long-term liability activity for the year ended September 30, 2016 was as follows:

| | Beginning Balance 10/1/15 | Additions | Reductions | Ending Balance 9/30/16 | Due Within One Year |
|---|---------------------------------|-----------------|-------------------|------------------------------|------------------------|
| Governmental Activities: | | | | | |
| General Obligation Bonds | \$ 560,000 | \$ - | \$ 107,000 | \$ 453,000 | \$ 110,000 |
| Capital Leases | 19,011 | - | 5,801 | 13,210 | 5,094 |
| Net Pension Liability | 12,663 | 1,889 | - | 14,552 | - |
| Governmental Activity Long-Term Liabilities | \$ 591,674 | \$ 1,889 | \$ 112,801 | \$ 480,762 | \$ 115,094 |
| Business-type Activities: | | | | | |
| Capital Leases | \$ 21,855 | \$ - | \$ 13,692 | \$ 8,163 | \$ 8,163 |
| Net Pension Liability | 74,482 | 9,558 | - | 84,040 | - |
| Business-type Activity Long-Term Liabilities | \$ 96,337 | \$ 9,558 | \$ 13,692 | \$ 92,203 | \$ 8,163 |

NOTE 5: OTHER INFORMATION

A. 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; and natural disasters for which the City participates along with 2,617 other entities in the Texas Municipal League's Intergovernmental Risk Pool (the "Pool"). The Pool purchases commercial insurance at group rates for participants in the Pool. The City has no additional risk or responsibility to the Pool, outside of the payment of insurance premiums. The City has not significantly reduced insurance coverage or had settlements which exceeded coverage amounts for the past three years.

B. Contingent Liabilities

Amounts received or receivables from granting agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amounts of expenditures which may be disallowed by the grantor cannot be determined at this time, although the City expects such amounts, if any, to be immaterial.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends, including frequency and amount of payouts, and other economic and social factors. No claim liabilities are reported at year end.

NOTE 6: DEFINED BENEFIT PENSION PLAN

A. Plan Description

The City of Elkhart participates as one of 866 plans in the nontraditional, joint contributory, hybrid defined benefit pension plan administered by the Texas Municipal Retirement System (TMRS). TMRS is an agency created by the State of Texas and administered in accordance with the TMRS Act, Subtitle G, Title 8, Texas Government Code (the TMRS Act) as an agent multiple-employer retirement system for municipal employees in the State of Texas.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

A. Plan Description - Continued

The TMRS Act places the general administration and management of the System with a six-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas. TMRS's defined benefit pension plan is a tax-qualified plan under Section 401(a) of the Internal Revenue Code. TMRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at www.tmr.com.

All eligible employees of the city are required to participate in TMRS.

B. Benefits Provided

TMRS provides retirement, disability, and death benefits. Benefit provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS.

At retirement, the benefit is calculated as if the sum of the employee's contributions, with interest, and the city-financed monetary credits with interest were used to purchase an annuity. Members may choose to receive their retirement benefit in one of seven payments options. Members may also choose to receive a portion of their benefit as a Partial Lump Sum Distribution in an amount equal to 12, 24, or 36 monthly payments, which cannot exceed 75% of the member's deposits and interest.

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

| | <u>Plan Year 2015</u> | <u>Plan Year 2014</u> |
|---|-----------------------|-----------------------|
| Employee deposit rate | 5.0% | 5.0% |
| Matching ratio (city to employee) | 1 to 1 | 1 to 1 |
| Year required for vesting | 5 | 5 |
| Service retirement eligibility (expressed as age/years of Service) | 60/5, 0/25 | 60/5, 0/25 |
| Updated Service Credit | 100% Repeating | 100% Repeating |
| Annuity Increase (to retirees) | 0% of CPI | 0% of CPI |

C. Employees Covered by Benefit Terms

At the December 31, 2015 valuation and measurement date, the following employees were covered by the benefit terms:

| | <u>12/31/2013</u> | <u>12/31/2014</u> | <u>12/31/2015</u> |
|--|-------------------|-------------------|-------------------|
| Inactive employees or beneficiaries currently receiving benefits | 8 | 7 | 5 |
| Inactive employees entitled to but not yet receiving benefits | 2 | 3 | 4 |
| Active employees | 4 | 2 | 3 |
| | <u>14</u> | <u>12</u> | <u>12</u> |

D. Contributions

The contribution rates for employees in TMRS are either 5%, 6%, or 7% of employee gross earnings, and the City matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of the City. Under the state law governing TMRS, the contribution rate for each city is determined annually by the actuary, using the Entry Age Normal (EAN) actuarial cost method.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

D. Contributions - Continued

The actuarially determined rate is the estimated amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

Employees for the City of Elkhart were required to contribute 5% of their annual gross earnings during the fiscal year. The contribution rates for the City of Elkhart were 5.00%, 5.65%, and 5.96% in calendar years 2014, 2015, and 2016, respectively. The City's contributions to TMRS for the year ended September 30, 2016, were \$13,490, and were equal to the required contributions.

E. Net Pension Liability

The City's Net Pension Liability (NPL) was measured as of December 31, 2015, and the Total Pension Liability (TPL) used to calculate the Net Pension Liability was determined by an actuarial valuation as of that date.

Actuarial assumptions:

The Total Pension Liability in the December 31, 2015 actuarial valuation was determined using the following actuarial assumptions:

| | |
|---------------------------|--|
| Inflation | 2.5% per year |
| Overall payroll growth | 3.0% per year |
| Investment Rate of Return | 6.75%, net of pension plan investment expense, including inflation |

Salary increases were based on a service-related table. Mortality rates for active members, retirees, and beneficiaries were based on the gender-distinct RP2000 Combined Healthy Mortality Table with Blue Collar Adjustment, with male rates multiplied by 109% and female rates multiplied by 103%.

For cities with fewer than twenty employees, more conservative methods and assumptions are used. First, lower termination rates are used for smaller cities, with maximum multipliers of 75% for employers with less than six members, 85% for employers with six to ten members, 100% for employers with eleven to fifteen members, and 115% for employers with less than 100 members. There is also a load on the life expectancy for employers with less than fifteen active members. The life expectancy will be loaded by decreasing the mortality rates by 1% for every active member less than fifteen.

The rates are projected on a fully generational basis by scale BB to account for future mortality improvements. For disabled annuitants, the gender-distinct RP2000 Combined Healthy Mortality Table with Blue Collar Adjustment, with male rates multiplied by 109% and female rates multiplied by 103% with a three year set-forward for both males and females. In addition, a 3% minimum mortality rate is applied to reflect the impairment for younger members who become disabled. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements subject to the 3% floor.

Actuarial assumptions used in the December 31, 2015, valuation were based on the results of actuarial experience studies. The experience study in TMRS was for the period December 31, 2010 through December 31, 2014. Healthy post-retirement mortality rates and annuity purchase rates were updated based on a Mortality Experience Investigation Study covering 2009 through 2011, and dated December 31, 2013. These assumptions were first used in the December 31, 2013 valuation, along with a change to the Entry Age Normal (EAN) actuarial cost method. Assumptions are reviewed annually. No additional changes were made for the 2014 valuation. After the Asset Allocation Study analysis and experience investigation study, the Board amended the long-term expected rate of return on pension plan investments from 7% to 6.75%. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

E. Net Pension Liability - Continued

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense, and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. In determining their best estimate of a recommended investment return assumption under the various alternative asset allocation portfolios, GRS focused on the area between (1) arithmetic mean (aggressive) without an adjustment for time (conservative) and (2) the geometric mean (conservative) with an adjustment for time (aggressive). At its meeting on July 30, 2015, the TMRS Board approved a new portfolio target allocation. The target allocation and best estimates of real rates of return for each major asset class are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return (Arithmetic) |
|-----------------------|-------------------|---|
| Domestic Equity | 17.50% | 4.55% |
| International Equity | 17.50% | 6.10% |
| Core Fixed Income | 10.00% | 1.00% |
| Non-Core Fixed Income | 20.00% | 3.65% |
| Real Return | 10.00% | 4.03% |
| Real Estate | 10.00% | 5.00% |
| Absolute Return | 10.00% | 4.00% |
| Private Equity | 5.00% | 8.00% |
| Total | 100.00% | |

Discount Rate

The discount rate used to measure the Total Pension Liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rates specified in statute. Based on that assumption, the pension plan's Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability.

| | Increase (Decrease) | | |
|---|-------------------------|-----------------------------|-----------------------|
| | Total Pension Liability | Plan Fiduciary Net Position | Net Pension Liability |
| | (a) | (b) | (a)-(b) |
| Balance at 12/31/2014 | \$ 679,334 | \$ 592,189 | \$ 87,145 |
| Changes for the year: | | | |
| Service cost | 22,129 | - | 22,129 |
| Interest | 47,393 | - | 47,393 |
| Change of benefit terms | - | - | - |
| Difference between expected and actual experience | (40,920) | - | (40,920) |
| Changes of assumptions | 11,482 | - | 11,482 |
| Contributions - employer | - | 15,022 | (15,022) |
| Contributions - employee | - | 13,299 | (13,299) |
| Net investment income | - | 874 | (874) |
| Benefit payments, including refunds of employee contributions | (26,705) | (26,705) | - |
| Administrative expense | - | (532) | 532 |
| Other changes | - | (27) | 27 |
| Net changes | 13,379 | 1,931 | 11,448 |
| Balance at 12/31/2015 | \$ 692,713 | \$ 594,120 | \$ 98,593 |

CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016

E. Net Pension Liability - Continued

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

The following presents the net pension liability of the City, calculated using the discount rate of 6.75%, as well as what the City's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.75%) or 1-percentage-point higher (7.75%) than the current rate:

| | 1% Decrease in Discount Rate (5.75%) | Discount Rate (6.75%) | 1% Increase in Discount Rate (7.75%) |
|------------------------------|---|-----------------------|---|
| City's net pension liability | \$ 191,981 | \$ 98,593 | \$ 22,263 |

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's Fiduciary Net Position is available in a separately-issued TMRS financial report. That report may be obtained on the Internet at www.tmrs.com.

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

For the year ended September 30, 2016, the city recognized pension expense of \$21,885.

At September 30, 2016, the City reported deferred outflows of resource and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|-----------------------------------|----------------------------------|
| Differences between expected and actual economic experience | \$ - | \$ 22,080 |
| Changes in actuarial assumptions | 9,278 | - |
| Difference between projected and actual investment earnings | 38,257 | - |
| Amortization of prior period deferred outflows | (4,091) | - |
| Amortization of prior period deferred inflows | - | - |
| Contributions subsequent to the measurement date | 9,822 | - |
| Total | \$ 53,266 | \$ 22,080 |

\$9,822 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending September 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| | Year Ended December 31 |
|------------|------------------------|
| 2016 | \$ 6,557 |
| 2017 | 6,557 |
| 2018 | 6,559 |
| 2019 | 2,879 |
| 2020 | (1,188) |
| Thereafter | - |
| | \$ 21,364 |

**CITY OF ELKHART, TEXAS
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

NOTE 7: COMMITMENTS

Effective October 1, 2007, the City entered into a contract with Hutto Garbage Service (currently Progressive Waste Solutions of Texas, Inc.) for the collection of garbage for the City's residents. The contract period under the agreement ends October 1, 2010 and is renewed every three years unless either party gives written notice of termination. The contract calls for various base rates for collection services. The City paid \$146,434 during the fiscal year for this services. The payment is reported by the City's Utility Fund as an operating expense.

NOTE 8: SUBSEQUENT EVENTS

In April of 2018, the Council approved the early extinguishment of the 2015 General Obligation Refunding Bonds. Effective May 1, 2018, the City paid the remaining principal balance on the bonds in the amount of \$231,000.

In June 2018, the City was notified by the Texas Commission on Environmental Quality (TCEQ) that an amended schedule for compliance with ordering provisions was approved and the City is in the process of meeting these requirements.

Subsequent events have been evaluated through September 17, 2018, the date the financial statements were available to be issued.

REQUIRED SUPPLEMENTAL INFORMATION

CITY OF ELKHART, TEXAS
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS
FISCAL YEAR ENDED SEPTEMBER 30, 2016

| | 2014 | 2015 |
|--|------------|------------|
| Total Pension Liability | | |
| Service Cost | \$ 23,475 | \$ 22,129 |
| Interest (on the Total Pension Liability) | 44,030 | 47,393 |
| Changes in benefit terms | - | - |
| Difference between expected and actual results | 13,629 | (40,921) |
| Change of assumptions | - | 11,482 |
| Benefit payments, including refunds of employee contributions | (38,116) | (26,705) |
| Net Change in Total Pension Liability | 43,018 | 13,378 |
| Total Pension Liability - Beginning | 636,316 | 679,334 |
| Total Pension Liability - Ending (a) | \$ 679,334 | \$ 692,712 |
| Plan Fiduciary Net Position | | |
| Contributions - Employer | \$ 15,960 | \$ 15,022 |
| Contributions - Employee | 15,983 | 13,299 |
| Net Investment Income | 32,401 | 874 |
| Benefit payments, including refunds of employee contributions | (38,116) | (26,705) |
| Administrative Expense | (338) | (532) |
| Other | (28) | (27) |
| Net Change in Plan Fiduciary Net Position | 25,862 | 1,931 |
| Plan Fiduciary Net Position - Beginning | 566,327 | 592,189 |
| Plan Fiduciary Net Position - Ending (b) | \$ 592,189 | \$ 594,120 |
| Net Pension Liability (Asset) - Ending (a)-(b) | \$ 87,145 | \$ 98,592 |
| Plan Fiduciary Net Position as a Percentage of Total Pension Liability | 87.17% | 85.77% |
| Covered Employee Payroll | \$ 319,650 | \$ 265,977 |
| Net Pension Liability as a Percentage of Covered Employee Payroll | 27.26% | 37.07% |

Notes to Schedule:

This schedule will present 10 years information when it becomes available.

**CITY OF ELKHART, TEXAS
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF CONTRIBUTIONS
FISCAL YEAR ENDED SEPTEMBER 30, 2016**

| | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|---|---------------|---------------|---------------|
| Actuarially Determined Contribution | \$ 11,139 | \$ 15,697 | \$ 13,490 |
| Contributions in relation to the actuarially determined contributions | <u>11,139</u> | <u>15,697</u> | <u>13,490</u> |
| Contribution deficiency (Excess) | \$ - | \$ - | \$ - |
| Covered employee payroll | \$ 300,634 | \$ 287,662 | \$ 229,715 |
| Contributions as a percentage of covered employee payroll | 3.71% | 5.46% | 5.87% |

NOTES TO SCHEDULE OF CONTRIBUTIONS

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

Methods and Assumptions Used to Determine Contribution Rates:

| | |
|-------------------------------|---|
| Actuarial Cost Method | Entry Age Normal |
| Amortization Method | Level Percentage of Payroll, Closed |
| Remaining Amortization Period | 21 years |
| Asset Valuation Method | 10 Year smoothed market; 15% soft corridor |
| Inflation | 2.50% |
| Salary Increases | 3.50% to 10.50% including inflation |
| Investment Rate of Return | 6.75% |
| Retirement Age | Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2015 valuation pursuant to an experience study for the period 2010-2014 |
| Mortality | RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied 103% and projected on a fully generational basis with scale BB |
| Other Information: | There were no benefit changes during the year. |

COMPLIANCE AND INTERNAL CONTROL 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**

Independent Auditors' Report

To the City Council
City of Elkhart, Texas

We have audited, 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, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Elkhart, Texas as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the City of Elkhart, Texas' basic financial statements, and have issued our report thereon dated September 17, 2018.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Gallot Morgan Paddy PC

Certified Public Accountants

Tyler, Texas
September 17, 2018



To the City Council
City of Elkhart, Texas

We have audited the financial statements of the City of Elkhart, Texas as of and for the year ended September 30, 2016, and have issued our report thereon dated September 17, 2018. Professional standards require that we advise you of the following matters relating to our audit.

Our Responsibility in Relation to the Financial Statement Audit

As communicated in our engagement letter dated April 23, 2018, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, as part of our audit, we considered the internal control of City of Elkhart, Texas solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

Planned Scope and Timing of the Audit

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, and our firm, and other network firms have complied with all relevant ethical requirements regarding independence.

Qualitative Aspects of the Entity's Significant Accounting Practices

Significant Accounting Policies

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by City of Elkhart, Texas is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2016. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimate affecting the financial statements is as follows:

Management's estimate of the collectability of the uncollected property taxes and fine revenue is based on management's current judgment and past history of collections. We evaluated the key factors and assumptions used to develop the accounting estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

Management's estimate of the depreciation expense of capital assets. We evaluated the key factors and assumptions used to develop the accounting estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

Financial Statement Disclosures

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting City of Elkhart, Texas' financial statements relate to Note 6 – Defined Pension Benefit Plan.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

Uncorrected and Corrected Misstatements

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. Management has corrected all identified misstatements. In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. All material misstatements that we identified as a result of our audit procedures were brought to the attention of, and corrected by, management.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to City of Elkhart, Texas' financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Representations Requested from Management

We have requested certain written representations from management, which are included in the attached letter dated September 17, 2018.

Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Other Significant Matters, Findings, or Issues

In the normal course of our professional association with City of Elkhart, Texas, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as City of Elkhart, Texas' auditors.

Other Information in Documents Containing Audited Financial Statements

Pursuant to professional standards, our responsibility as auditors for other information in documents containing City of Elkhart, Texas' audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. However, in accordance with such standards, we have, with respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Our responsibility also includes communicating to you any information which we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

This report is intended solely for the information and use of the Mayor, City Council and management of the City of Elkhart, Texas and is not intended to be and should not be used by anyone other than these specified parties.



Certified Public Accountants

Tyler, Texas
September 17, 2018