

ANNUAL FINANCIAL REPORT

For The Fiscal Year Ended
September 30, 2015



City of Montgomery, Texas
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ANNUAL FINANCIAL REPORT

of the

City of Montgomery, Texas

**For the Year Ended
September 30, 2015**

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City of Montgomery, Texas

TABLE OF CONTENTS

September 30, 2015

FINANCIAL SECTION

| | |
|--------------------------------------|---|
| Independent Auditor's Report | 1 |
| Management's Discussion and Analysis | 7 |

Basic Financial Statements

Government-Wide Financial Statements

| | |
|---------------------------|----|
| Statement of Net Position | 18 |
| Statement of Activities | 20 |

Fund Financial Statements

Governmental Funds:

| | |
|--|----|
| Balance Sheet | 22 |
| Reconciliation of the Balance Sheet to the Statement of Net Position- Governmental funds | 25 |
| Statement of Revenues, Expenditures, and Changes in Fund Balance- Governmental Funds | 26 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities | 29 |

Proprietary Funds:

| | |
|---|----|
| Statement of Net Position | 30 |
| Statement of Revenues, Expenses, and Changes in Fund Net Position | 31 |
| Statement of Cash Flows | 32 |

| | |
|--------------------------------------|-----------|
| Notes to Financial Statements | 34 |
|--------------------------------------|-----------|

REQUIRED SUPPLEMENTARY INFORMATION

| | |
|---|----|
| Schedule of Revenues, Expenditures, and Changes in Fund Balances- Budget and Actual - General Fund | 67 |
| Schedule of Changes in Net Pension Liability (Asset) and Related Ratios | 68 |
| Schedule of Employer Contributions to Pension Plan | 69 |

OTHER SUPPLEMENTARY INFORMATION

| | |
|--|----|
| Schedule of Revenues, Expenditures, and Changes in Fund Balances- Budget and Actual – Debt Service Fund | 72 |
| Schedule of Revenues, Expenditures, and Changes in Fund Balances- Budget and Actual – Capital Projects Fund | 74 |

FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council
City of Montgomery, Texas:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Montgomery, Texas (the "City"), as of and for the year ended September 30, 2015, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

Management's Responsibility for the Financial Statements

The City's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes

evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City as of September 30, 2015 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note V.E. the City adopted new accounting guidance GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The schedules of revenues, expenditures, and changes in fund balances – budget and actual for the debt service fund, and capital projects fund are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary information noted above 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 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

A handwritten signature in black ink that reads "Brooks Cardiel, PLLC". The signature is written in a cursive, flowing style.

BrooksCardiel, PLLC
Certified Public Accountants
The Woodlands, Texas
February 16, 2016

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***MANAGEMENT'S DISCUSSION
AND ANALYSIS***

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City of Montgomery, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

September 30, 2015

The purpose of the Management's Discussion and Analysis (the "MD&A") is to give the readers an objective and easily readable analysis of the City of Montgomery's (the "City") financial activities for the year ending September 30, 2015. The analysis is based on currently known facts, decisions, or economic conditions. It presents short and long-term analysis of the City's activities, compares current-year results with those of the prior year, and discusses the positive and negative aspects of that comparison. GASB Statement No. 34 establishes the content of the minimum requirements for the MD&A. Please read the MD&A in conjunction with the City's financial statements, which follow this section.

The annual financial report is presented as compliant with the financial reporting model in effect pursuant to GASB Statement No. 34. This financial reporting model requires governments to present certain basic financial statements as well as an MD&A and certain other Required Supplementary Information (RSI). The basic financial statements include (1) government-wide financial statements, (2) individual fund financial statements, and (3) notes to the financial statements.

Financial Highlights

- The City's total combined net position was \$5,090,209 at September 30, 2015. Of this, \$1,098,191 (unrestricted net position) may be used to meet the City's ongoing obligations to its citizens and creditors.
- At the close of the current fiscal year, the City's governmental funds reported combined fund balances of \$1,541,399, a decrease of \$45,168.
- As of the end of the year, the unassigned fund balance of the general fund was \$1,170,839 or 52% of total general fund expenditures.
- The City had an overall decrease in net position of \$99,954, which is primarily due to expenses increasing at a greater rate than revenues compared to prior year.

Government-Wide Statements

The government-wide statements report information for the City as a whole. These statements include transactions and balances relating to all assets, including infrastructure capital assets. These statements are designed to provide information about cost of services, operating results, and financial position of the City as an economic entity. The Statement of Net Position and the Statement of Activities, which appear first in the City's financial statements, report information on the City's activities that enable the reader to understand the financial condition of the City of Montgomery. These statements are prepared using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account even if cash has not yet changed hands.

City of Montgomery, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2015

The Statement of Net Position presents information on all of the City's assets and liabilities. The difference between the two is 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. Other non-financial factors, such as the City's property tax base and the condition of the City's infrastructure, need to be considered in order to assess the overall health of the City.

The Statement of Activities presents information showing how the City's net position changed during the most recent year. All changes in the net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows – the accrual method rather than modified accrual that is used in the fund level statements.

The Statement of Net Position and the Statement of Activities divide the City into three classes of activities:

1. Governmental Activities - Most of the City's basic services are reported here, including general government, public safety (police, municipal court), and culture and recreation. Sales tax, property tax, franchise taxes, municipal court fees and fines and permit fees finance most of these activities.
2. Business-Type Activities - Services involving a fee for those services. These services, the City's water distribution, wastewater collection/treatment and sanitation services are reported here.
3. Component Unit Activities – Services provided to promote economic development within the City are funded by a one-half of one percent sales tax.

FUND FINANCIAL STATEMENTS

Funds may be considered as operating companies of the parent corporation, which is the City of Montgomery. They are usually segregated for specific activities or objectives. The City uses fund accounting to ensure and demonstrate compliance with finance-related legal reporting requirements. The two categories of City funds are governmental and proprietary.

Governmental Funds

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar

City of Montgomery, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2015

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

The City maintains three individual major governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general and debt service funds which are considered to be major funds.

The City adopts an annual appropriated budget for its general, debt service, capital projects, utility, and component unit funds. A budgetary comparison schedule has been provided to demonstrate compliance with these budgets.

Proprietary Funds

The City maintains one type of proprietary fund. Proprietary funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses proprietary funds to account for its water distribution, wastewater collection/treatment, water construction operations and sanitation services. The proprietary fund financial statements provide separate information for the water distribution, wastewater collection/treatment fund, and sanitation funds. The basic proprietary fund financial statements can be found in the basic financial statements of this report.

Component Unit

The City has a component unit, the Montgomery Economic Development Corporation (MEDC), whose purpose is to promote economic development within the City. The city uses the funds for the MEDC to provide improvements to the City's culture, recreation, conservation, and development. Component unit financial statements accompany the governmental funds financial statements.

Notes to Financial Statements

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

Other Information

In addition to the basic financial statements, MD&A, and accompanying notes, this report also presents certain Required Supplementary Information (RSI). The RSI that GASB Statement No. 34 requires

City of Montgomery, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*
September 30, 2015

includes a budgetary comparison schedule for the general fund and schedule of funding progress for Texas Municipal Retirement System. RSI can be found after the basic financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted previously, net position may serve over time as a useful indicator of the City's financial position. For the City, assets exceed liabilities by \$5,090,209 as of September 30, 2015, in the primary government.

The largest portion of the City's net position, \$3,664,006, reflects its investments in capital assets (e.g., land, city hall, police station, streets, and drainage systems, as well as the public works facilities), less any debt used to acquire those assets that are still 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.

City of Montgomery, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2015

Statement of Net Position:

The following table reflects the condensed Statement of Net Position:

| | 2015 | | | 2014 | | |
|---------------------------|----------------------------|-----------------------------|---------------------|----------------------------|-----------------------------|---------------------|
| | Governmental Activities | Business-Type Activities | Total | Governmental Activities | Business-Type Activities | Total |
| Current and | | | | | | |
| other assets | \$ 2,157,616 | \$ 345,046 | \$ 2,502,662 | \$ 1,996,297 | \$ 447,562 | \$ 2,443,859 |
| Capital assets, net | 2,668,325 | 7,883,722 | 10,552,047 | 2,710,597 | 8,070,618 | 10,781,215 |
| Total Assets | 4,825,941 | 8,228,768 | 13,054,709 | 4,706,894 | 8,518,180 | 13,225,074 |
| Total Deferred | | | | | | |
| Outflows | 37,152 | 3,511 | 40,663 | 16,098 | 1,789 | 17,887 |
| Other liabilities | 851,003 | 141,830 | 992,833 | 622,256 | 99,614 | 721,870 |
| Long-term liabilities | 6,971,068 | - | 6,971,068 | 7,292,113 | - | 7,292,113 |
| Total Liabilities | 7,822,071 | 141,830 | 7,963,901 | 7,914,369 | 99,614 | 8,013,983 |
| Total Deferred | | | | | | |
| Inflows | 37,136 | 4,126 | 41,262 | - | - | - |
| Net Position: | | | | | | |
| Net investment | | | | | | |
| in capital assets | (4,219,716) | 7,883,722 | 3,664,006 | (4,428,929) | 8,070,618 | 3,641,689 |
| Restricted | 310,561 | 17,451 | 328,012 | 125,674 | - | 125,674 |
| Unrestricted | 913,041 | 185,150 | 1,098,191 | 1,111,878 | 349,737 | 1,461,615 |
| Total Net Position | \$ (2,996,114) | \$ 8,086,323 | \$ 5,090,209 | \$ (3,191,377) | \$ 8,420,355 | \$ 5,228,978 |

City of Montgomery, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2015

Statement of Activities:

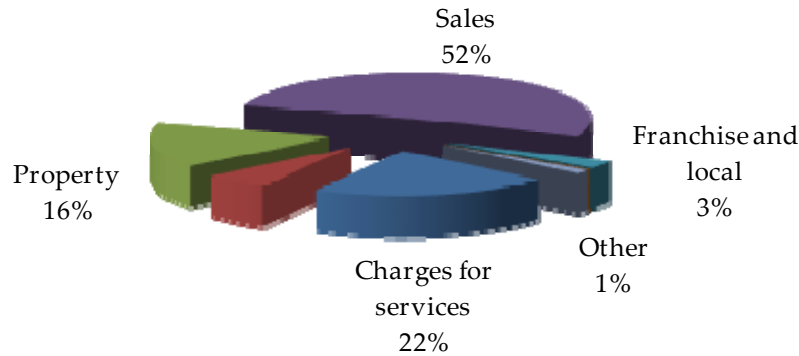
The following table provides a summary of the City's changes in net position:

| | For the Year Ended September 30, 2015 | | | For the Year Ended September 30, 2014 | | |
|--|---------------------------------------|-----------------------------|--------------------------------|---------------------------------------|-----------------------------|--------------------------------|
| | Governmental Activities | Business-Type Activities | Total Primary Government | Governmental Activities | Business-Type Activities | Total Primary Government |
| Revenues | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | \$ 570,719 | \$ 750,641 | \$ 1,321,360 | \$ 385,593 | \$ 697,038 | \$ 1,082,631 |
| Grants and contributions | 155,000 | 89,794 | 244,794 | 157,732 | 24,340 | 182,072 |
| General revenues: | | | | | | |
| Property | 409,172 | - | 409,172 | 371,002 | - | 371,002 |
| Sales | 1,348,055 | - | 1,348,055 | 1,318,303 | - | 1,318,303 |
| Franchise and local | 75,148 | - | 75,148 | 74,822 | - | 74,822 |
| Interest | 2,572 | 280 | 2,852 | 3,507 | 438 | 3,945 |
| Other | 36,494 | - | 36,494 | 33,702 | - | 33,702 |
| Total Revenues | 2,597,160 | 840,715 | 3,437,875 | 2,344,661 | 721,816 | 3,066,477 |
| Expenses | | | | | | |
| General government | 539,697 | - | 539,697 | 432,161 | - | 432,161 |
| Police department | 852,976 | - | 852,976 | 640,471 | - | 640,471 |
| Municipal court | 242,285 | - | 242,285 | 172,851 | - | 172,851 |
| Public works | 551,790 | - | 551,790 | 469,356 | - | 469,356 |
| Interest and fiscal charges | 268,228 | - | 268,228 | 267,221 | - | 267,221 |
| Water, sewer, & sanitation | - | 1,082,853 | 1,082,853 | - | 788,986 | 788,986 |
| Total Expenses | 2,454,976 | 1,082,853 | 3,537,829 | 1,982,060 | 788,986 | 2,771,046 |
| Change in Net Position before Transfers | 142,184 | (242,138) | (99,954) | 362,601 | (67,170) | 295,431 |
| Transfers | 86,403 | (86,403) | - | (1,434,989) | 1,434,989 | - |
| Total | 86,403 | (86,403) | - | (1,434,989) | 1,434,989 | - |
| Change in Net Position | 228,587 | (328,541) | (99,954) | (1,072,388) | 1,367,819 | 295,431 |
| Beginning Net Position | (3,224,701) | 8,414,864 | 5,190,163 | (2,118,989) | 7,052,536 | 4,933,547 |
| Ending Net Position | \$ (2,996,114) | \$ 8,086,323 | \$ 5,090,209 | \$ (3,191,377) | \$ 8,420,355 | \$ 5,228,978 |

City of Montgomery, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2015

Graphic presentations of selected data from the summary tables are displayed below to assist in the analysis of the City's activities.

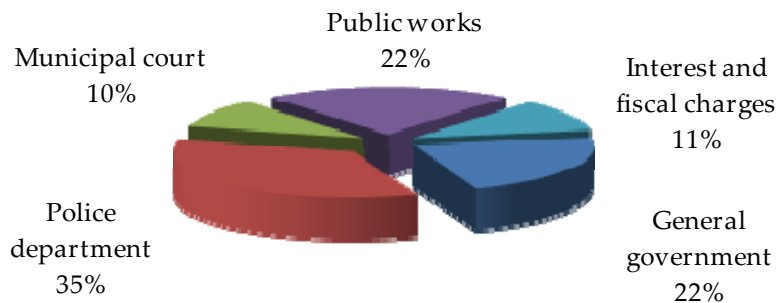
Governmental Activities - Revenues



For the year ended September 30, 2015, revenues from governmental activities totaled \$2,597,160. Sales taxes, property taxes, and fees & forfeitures are the City's largest revenue sources. Sales tax increased \$29,752 or 2% due to inflation. Court fines and fees increased by \$185,126 due to a fully staffed police force as compared to prior year. All other revenues remained relatively stable when compared to the previous year.

This graph shows the governmental function expenses of the City:

Governmental Activities - Expenses

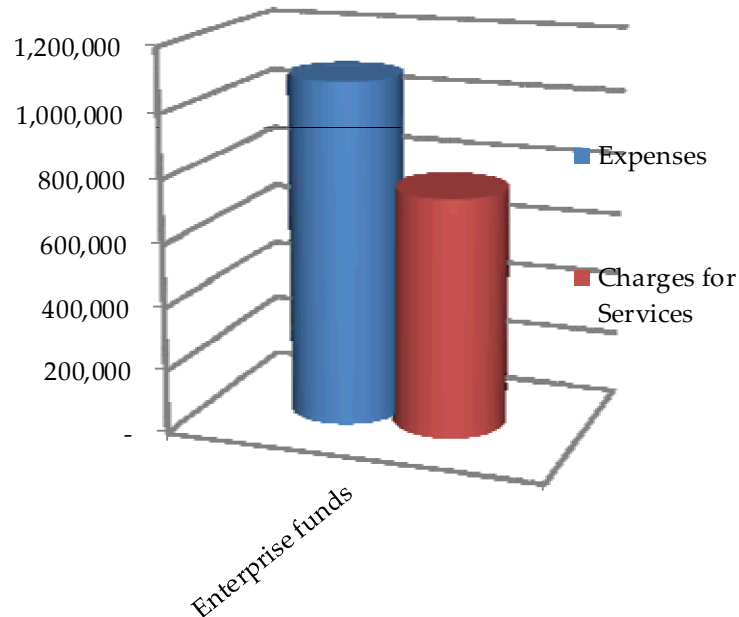


For the year ended September 30, 2015, expenses for governmental activities totaled \$2,454,976. This represents an increase of \$472,916 or 13% from the prior year. The City's largest functional expense is the police department of \$852,976 which is primarily salaries of police officers and equipment. All areas with the exception of interest and expense increased by 18% or more in the current year due to the City filling open personnel positions.

City of Montgomery, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2015

Business-type activities are shown comparing operating costs to revenues generated by related services.

Business-Type Activities - Revenues and Expenses



For the year ended September 30, 2015, charges for services by business-type activities totaled \$750,641. This is an increase of \$53,603, or 4%, from the previous year. This increase directly relates to an increase in water usage.

Total expenses increased \$299,442 compared to prior year, at total of 37%. These increases are mostly related to engineering and maintenance expenses as the City prepares for growth and manages ongoing maintenance.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As noted earlier, fund accounting is used to demonstrate and ensure compliance with finance-related legal requirements.

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

City of Montgomery, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued

September 30, 2015

As of the end of the year the general fund reflected a total fund balance of \$1,170,839, all of which is unassigned.

There was a decrease in total governmental fund balance of \$45,168 over the prior year. The decrease was due to planned decreases in the capital projects fund as well as increased general fund expenditures outpacing general fund revenues.

Proprietary Funds - The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

GENERAL FUND BUDGETARY HIGHLIGHTS

There was a total negative budget variance of \$32,022 in the general fund. This is due primarily to a negative revenue variance of \$67,439. In general, expenditures were less than budgeted.

CAPITAL ASSETS

As of the end of the year, the City's governmental activities funds had invested \$2,668,325 in a variety of capital assets and infrastructure, net of accumulated depreciation. Depreciation is included with the governmental capital assets as required by GASB Statement No. 34. The City's business-type activities funds had invested \$7,883,722 in a variety of capital assets and infrastructure, net of accumulated depreciation.

Major capital asset events during the current year include the following:

- Three police vehicles for a total of \$115,746
- The completion of improvements to Water Plant #3 – Catahoula Well in the amount of \$1,002,921
- The completion and contribution of a utility extension for a local business by the Magnolia Economic Development Corporation in the amount of \$89,794.

More detailed information about the City's capital assets is presented in note IV. C to the financial statements.

LONG-TERM DEBT

At the end of the current year, the City had total bonds outstanding of \$7,075,000. During the year, the City issued a refunding bond in the amount of \$845,000 and made debt payments of \$245,000. More detailed information about the City's long-term liabilities is presented in note IV. E. to the financial statements.

City of Montgomery, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2015

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Mayor and City Council are committed to maintaining and improving the overall wellbeing of the City of Montgomery and improving services provided to their public citizens. The City is budgeting for growth in the upcoming year.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the City of Montgomery's finances for all those with an interest in the City's finances. Questions concerning this report or requests for additional financial information should be directed to the City Administrator, City of Montgomery, P.O. Box 708, Montgomery, Texas 77356.

FINANCIAL STATEMENTS

City of Montgomery, Texas
STATEMENT OF NET POSITION (Page 1 of 2)
September 30, 2015

| | Primary Government | | | Component Unit |
|--|----------------------------|-----------------------------|-------------------|----------------|
| | Governmental Activities | Business-Type Activities | Total | MEDC |
| <u>Assets</u> | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 1,441,260 | \$ 223,609 | \$ 1,664,869 | \$ 468,743 |
| Investments | 300,000 | - | 300,000 | 100,000 |
| Receivables, net | 250,644 | 112,395 | 363,039 | 111,381 |
| Prepays | 240 | - | 240 | 8,350 |
| Internal balances | 8,409 | (8,409) | - | - |
| Total Current Assets | 2,000,553 | 327,595 | 2,328,148 | 688,474 |
| Net pension asset | 157,063 | 17,451 | 174,514 | - |
| Capital assets: | | | | |
| Non-depreciable | 768,985 | 74,382 | 843,367 | - |
| Net depreciable capital assets | 1,899,340 | 7,809,340 | 9,708,680 | - |
| Total Non-Current Assets | 2,825,388 | 7,901,173 | 10,726,561 | - |
| Total Assets | 4,825,941 | 8,228,768 | 13,054,709 | 688,474 |
| <u>Deferred Outflows of Resources</u> | | | | |
| Pension contributions | 23,493 | 2,610 | 26,103 | - |
| Pension investment earnings | 8,111 | 901 | 9,012 | - |
| Deferred charge on refunding | 5,548 | - | 5,548 | - |
| Total Deferred Outflows of Resources | 37,152 | 3,511 | 40,663 | - |

City of Montgomery, Texas
STATEMENT OF NET POSITION (Page 2 of 2)
September 30, 2015

| | Primary Government | | | Component Unit |
|---|-----------------------|---------------------|---------------------|-------------------|
| | Governmental | Business-Type | | |
| | Activities | Activities | Total | MEDC |
| <u>Liabilities</u> | | | | |
| Current liabilities: | | | | |
| Accounts payable and | | | | |
| accrued liabilities | 407,571 | 83,403 | 490,974 | 12,344 |
| Customer deposits | - | 51,498 | 51,498 | - |
| Compensated absences | 37,821 | 5,812 | 43,633 | - |
| Due to other governments | 33,751 | 1,117 | 34,868 | 1,071 |
| Accrued interest payable | 17,440 | - | 17,440 | - |
| Due within one year | 354,420 | - | 354,420 | 19,807 |
| Total Current Liabilities | 851,003 | 141,830 | 992,833 | 33,222 |
| Noncurrent liabilities: | | | | |
| Due in more than one year | 6,971,068 | - | 6,971,068 | 18,366 |
| Total Liabilities | 7,822,071 | 141,830 | 7,963,901 | 51,588 |
| <u>Deferred Inflows of Resources</u> | | | | |
| Actual pension experience | | | | |
| vs. assumption | 37,136 | 4,126 | 41,262 | - |
| <u>Net Position</u> | | | | |
| Net investment in capital assets | (4,219,716) | 7,883,722 | 3,664,006 | - |
| Restricted | 310,561 | 17,451 | 328,012 | 636,886 |
| Unrestricted | 913,041 | 185,150 | 1,098,191 | - |
| Total Net Position | \$ (2,996,114) | \$ 8,086,323 | \$ 5,090,209 | \$ 636,886 |

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF ACTIVITIES

For the Year Ended September 30, 2015

| Functions/Programs | Expenses | Program Revenues | |
|---------------------------------------|---------------------|----------------------|------------------------------------|
| | | Charges for Services | Operating Grants and Contributions |
| Primary Government | | | |
| Governmental Activities | | | |
| General government | \$ 539,697 | \$ 153,565 | \$ 155,000 |
| Police department | 852,976 | 417,154 | - |
| Municipal court | 242,285 | - | - |
| Public works | 551,790 | - | - |
| Interest and fiscal charges | 268,228 | - | - |
| Total Governmental Activities | 2,454,976 | 570,719 | 155,000 |
| Business-Type Activities | | | |
| Water, Sewer, & Sanitation | 1,082,853 | 750,641 | 89,794 |
| Total Business-Type Activities | 1,082,853 | 750,641 | 89,794 |
| Total Primary Government | \$ 3,537,829 | \$ 1,321,360 | \$ 244,794 |
| Primary Government | | | |
| Montgomery Economic | | | |
| Development Corporation (MEDC) | \$ 390,922 | \$ - | \$ - |

General Revenues:

Taxes
 Property
 Sales
 Franchise and local
 Interest
 Other
 Transfers

Total General Revenues and Transfers

Change in Net Position

Beginning Net Position

Ending Net Position

See Notes to Financial Statements.

Net (Expense) Revenue and Changes in Net Position

| Primary Government | | | Component Unit |
|---------------------------|----------------------|--------------------|-----------------------|
| Governmental | Business-Type | | MEDC |
| Activities | Activities | Total | |
| <hr/> | | | |
| \$ (231,132) | \$ - | \$ (231,132) | \$ - |
| (435,822) | - | (435,822) | - |
| (242,285) | - | (242,285) | - |
| (551,790) | - | (551,790) | - |
| (268,228) | - | (268,228) | - |
| <hr/> (1,729,257) | <hr/> - | <hr/> (1,729,257) | <hr/> - |
| <hr/> | | | |
| - | (242,418) | (242,418) | - |
| <hr/> - | <hr/> (242,418) | <hr/> (242,418) | <hr/> - |
| <hr/> (1,729,257) | <hr/> (242,418) | <hr/> (1,971,675) | <hr/> - |
| <hr/> | | | |
| \$ - | \$ - | \$ - | \$ (390,922) |
| <hr/> | | | |
| 409,172 | - | 409,172 | - |
| 1,348,055 | - | 1,348,055 | 449,352 |
| 75,148 | - | 75,148 | - |
| 2,572 | 280 | 2,852 | 603 |
| 36,494 | - | 36,494 | 1,664 |
| 86,403 | (86,403) | - | - |
| <hr/> 1,957,844 | <hr/> (86,123) | <hr/> 1,871,721 | <hr/> 451,619 |
| 228,587 | (328,541) | (99,954) | 60,697 |
| (3,224,701) | 8,414,864 | 5,190,163 | 576,189 |
| <hr/> \$ (2,996,114) | <hr/> \$ 8,086,323 | <hr/> \$ 5,090,209 | <hr/> \$ 636,886 |
| <hr/> | | | |

City of Montgomery, Texas

BALANCE SHEET GOVERNMENTAL FUNDS September 30, 2015

| | General | Debt Service | Capital Projects | Nonmajor Hotel Tax |
|--|---------------------|-------------------|---------------------|--------------------------|
| <u>Assets</u> | | | | |
| Cash and cash equivalents | \$ 995,413 | \$ 106,034 | \$ 313,176 | \$ 9,400 |
| Investments | 300,000 | - | - | - |
| Receivables, net | 239,343 | 11,301 | - | - |
| Prepaid insurance | 240 | - | - | - |
| Due from other funds | 8,409 | 16,487 | - | - |
| Total Assets | \$ 1,543,405 | \$ 133,822 | \$ 313,176 | \$ 9,400 |
| <u>Liabilities</u> | | | | |
| Accounts payable and accrued liabilities | \$ 311,457 | \$ - | \$ 96,114 | \$ - |
| Due to other governments | 33,751 | - | - | - |
| Due to other funds | 20,577 | - | - | - |
| Total Liabilities | 365,785 | - | 96,114 | - |
| <u>Deferred Inflows of Resources</u> | | | | |
| Unavailable revenue - Property taxes | 6,781 | 11,051 | - | - |
| Total Deferred Inflows | 6,781 | 11,051 | - | - |
| <u>Fund Balances</u> | | | | |
| Restricted for: | | | | |
| Enabling legislation | - | - | - | - |
| Debt service | - | 122,771 | - | - |
| Tourism | - | - | - | 9,400 |
| Committed for: | | | | |
| Capital improvements | - | - | 217,062 | - |
| Unassigned reported in: | | | | |
| General fund | 1,170,839 | - | - | - |
| Total Fund Balances | 1,170,839 | 122,771 | 217,062 | 9,400 |
| Total Liabilities and Fund Balances | \$ 1,543,405 | \$ 133,822 | \$ 313,176 | \$ 9,400 |

See Notes to Financial Statements.

| Nonmajor Police & Court | Total Governmental Funds |
|--|---|
| \$ 17,237 | \$ 1,441,260 |
| - | 300,000 |
| - | 250,644 |
| - | 240 |
| 4,090 | 28,986 |
| <u>\$ 21,327</u> | <u>\$ 2,021,130</u> |

| | |
|----------|----------------|
| \$ - | \$ 407,571 |
| - | 33,751 |
| - | 20,577 |
| <u>-</u> | <u>461,899</u> |

| | |
|----------|---------------|
| <u>-</u> | <u>17,832</u> |
| <u>-</u> | <u>17,832</u> |

| | |
|------------------|---------------------|
| 21,327 | 21,327 |
| - | 122,771 |
| - | 9,400 |
| - | 217,062 |
| - | 1,170,839 |
| <u>21,327</u> | <u>1,541,399</u> |
| <u>\$ 21,327</u> | <u>\$ 2,021,130</u> |

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City of Montgomery, Texas

RECONCILIATION OF THE BALANCE SHEET TO THE STATEMENT OF NET POSITION GOVERNMENTAL FUNDS

September 30, 2015

| | | |
|---|-----------|------------------|
| Fund Balances - Total Governmental Funds | \$ | 1,541,399 |
|---|-----------|------------------|

Adjustments for the Statement of Net Position:

Capital assets used in governmental activities are not current financial resources and, therefore, not reported in the governmental funds.

| | |
|----------------------------------|---------|
| Capital assets - non-depreciable | 768,985 |
|----------------------------------|---------|

| | |
|----------------------------------|-----------|
| Capital assets - net depreciable | 1,899,340 |
|----------------------------------|-----------|

Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the governmental funds.

| | |
|-------------------------|--------|
| Property tax receivable | 17,832 |
|-------------------------|--------|

| | |
|-------------------|---------|
| Net pension asset | 157,063 |
|-------------------|---------|

Deferred outflows of resources represent a consumption of net position that applies to a future period(s) and is not recognized as an outflow of resources (expense/expenditure) until then.

| | |
|-----------------------|--------|
| Pension contributions | 23,493 |
|-----------------------|--------|

| | |
|-----------------------------|-------|
| Pension investment earnings | 8,111 |
|-----------------------------|-------|

| | |
|------------------------------|-------|
| Deferred charge on refunding | 5,548 |
|------------------------------|-------|

Deferred inflows of resources represent 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.

| | |
|----------------|----------|
| Pension losses | (37,136) |
|----------------|----------|

Some liabilities, including bonds payable and deferred charges, are not reported as liabilities in the governmental funds.

| | |
|------------------|----------|
| Accrued interest | (17,440) |
|------------------|----------|

| | |
|--------------|-----------|
| Bond premium | (131,765) |
|--------------|-----------|

| | |
|----------------------|----------|
| Compensated absences | (42,023) |
|----------------------|----------|

| | |
|---|-----------|
| Non-current liabilities due in one year | (354,420) |
|---|-----------|

| | |
|---|-------------|
| Non-current liabilities due in more than one year | (6,835,101) |
|---|-------------|

| | |
|--|-----------------------|
| Net Position of Governmental Activities | \$ (2,996,114) |
|--|-----------------------|

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE GOVERNMENTAL FUNDS

For the Year Ended September 30, 2015

| | General | Debt Service | Capital Projects | Nonmajor Hotel Tax |
|--|---------------------|-------------------|---------------------|--------------------------|
| <u>Revenues</u> | | | | |
| Property tax | \$ 153,132 | \$ 259,563 | \$ - | \$ - |
| Sales tax | 1,348,055 | - | - | - |
| Franchise and local taxes | 73,072 | - | - | 2,076 |
| License and permits | 153,565 | - | - | - |
| Intergovernmental | 37,500 | 117,500 | - | - |
| Fines and forfeitures | 395,058 | - | - | - |
| Interest | 2,245 | 190 | 105 | 16 |
| Other | 36,494 | - | - | - |
| Total Revenues | 2,199,121 | 377,253 | 105 | 2,092 |
| <u>Expenditures</u> | | | | |
| Current: | | | | |
| General government | 497,487 | - | - | - |
| Police department | 771,766 | - | - | - |
| Municipal court | 236,813 | - | - | - |
| Public works | 468,597 | - | - | - |
| Capital outlay | 191,309 | - | 41,073 | - |
| Debt Service: | | | | |
| Principal | - | 245,000 | - | - |
| Sales tax withheld by state | 68,051 | - | - | - |
| Interest and fiscal charges | - | 234,703 | - | - |
| Bond issuance costs | - | 38,430 | - | - |
| Total Expenditures | 2,234,023 | 518,133 | 41,073 | - |
| Excess of Revenues | | | | |
| Over (Under) Expenditures | (34,902) | (140,880) | (40,968) | 2,092 |
| <u>Other Financing Sources (Uses)</u> | | | | |
| Transfers in (out) | 2,880 | 125,300 | - | - |
| Refunding bonds issued | - | 845,000 | - | - |
| Payment to bond agent | - | (816,164) | - | - |
| Total Other Financing (Uses) | 2,880 | 154,136 | - | - |
| Net Change in Fund Balances | (32,022) | 13,256 | (40,968) | 2,092 |
| Beginning fund balances | 1,202,861 | 109,515 | 258,030 | 7,308 |
| Ending Fund Balances | \$ 1,170,839 | \$ 122,771 | \$ 217,062 | \$ 9,400 |

See Notes to Financial Statements.

| Nonmajor Police & Court | Total Governmental Funds |
|--|---|
| \$ - | \$ 412,695 |
| - | 1,348,055 |
| - | 75,148 |
| - | 153,565 |
| - | 155,000 |
| 22,096 | 417,154 |
| 16 | 2,572 |
| - | 36,494 |
| <u>22,112</u> | <u>2,600,683</u> |
| - | 497,487 |
| - | 771,766 |
| 6,758 | 243,571 |
| - | 468,597 |
| - | 232,382 |
| - | 245,000 |
| - | 68,051 |
| - | 234,703 |
| - | 38,430 |
| <u>6,758</u> | <u>2,799,987</u> |
| 15,354 | (199,304) |
| (2,880) | 125,300 |
| - | 845,000 |
| - | (816,164) |
| <u>(2,880)</u> | <u>154,136</u> |
| 12,474 | (45,168) |
| 8,853 | 1,586,567 |
| <u>\$ 21,327</u> | <u>\$ 1,541,399</u> |

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City of Montgomery, Texas

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

For the Year Ended September 30, 2015

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

| | | |
|---|----|----------|
| Net changes in fund balances - total governmental funds | \$ | (45,168) |
|---|----|----------|

Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

| | | |
|----------------------|--|-----------|
| Capital outlay | | 160,016 |
| Depreciation expense | | (202,288) |

| | | |
|--|--|---------|
| Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. | | (3,523) |
|--|--|---------|

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.

| | | |
|----------------------|--|--------|
| Compensated absences | | 18,735 |
| Accrued interest | | (306) |
| Pension expense | | 11,695 |

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 issuance costs, premiums, discounts, and similar items when they are 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.

| | | |
|---|--|---------|
| Net change in deferred charges on refunding | | 5,548 |
| Amortization of premium | | 5,827 |
| Principal payments | | 278,051 |

| | | |
|--|-----------|----------------|
| Change in Net Position of Governmental Activities | \$ | 228,587 |
|--|-----------|----------------|

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF NET POSITION

PROPRIETARY FUND

September 30, 2015

| | <u>Water Sewer & Sanitation</u> |
|--|---|
| <u>Assets</u> | |
| <u>Current Assets</u> | |
| Cash and cash equivalents | \$ 223,609 |
| Receivables, net | 112,395 |
| Total Current Assets | <u>336,004</u> |
| <u>Noncurrent Assets</u> | |
| Net pension asset | 17,451 |
| Capital assets: | |
| Non-depreciable | 74,382 |
| Net depreciable capital assets | 7,809,340 |
| Total Noncurrent Assets | <u>7,901,173</u> |
| Total Assets | <u>8,237,177</u> |
| <u>Deferred Outflows of Resources</u> | |
| Pension contributions | 2,610 |
| Pension investment earnings | 901 |
| Total Deferred Outflows | <u>3,511</u> |
| <u>Liabilities</u> | |
| <u>Current Liabilities</u> | |
| Accounts payable and accrued liabilities | 83,403 |
| Customer deposits | 51,498 |
| Compensated absences | 5,812 |
| Due to other governments | 1,117 |
| Due to other funds | 8,409 |
| Total Current Liabilities | <u>150,239</u> |
| <u>Deferred Inflows of Resources</u> | |
| Actual pension experience vs. assumption | <u>4,126</u> |
| <u>Net Position</u> | |
| Net investment in capital assets | 7,883,722 |
| Unrestricted | 202,601 |
| Total Net Position | <u><u>\$ 8,086,323</u></u> |

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION PROPRIETARY FUND

For the Year Ended September 30, 2015

| | Water Sewer & Sanitation |
|--|--------------------------------|
| <u>Operating Revenues</u> | |
| Water sales | \$ 296,896 |
| Sewer revenue | 168,747 |
| Garbage collection | 70,832 |
| Meter installations | 199,745 |
| Late charges | 14,421 |
| Total Operating Revenues | 750,641 |
| <u>Operating Expenses</u> | |
| Cost of water | 531,708 |
| Cost of sewer | 50,726 |
| Cost of garbage | 69,526 |
| Salary and wages | 89,213 |
| Depreciation | 341,680 |
| Total Operating Expenses | 1,082,853 |
| Operating Loss | (332,212) |
| <u>Nonoperating Revenues (Expenses)</u> | |
| Investment income | 280 |
| Contributed capital | 89,794 |
| Total Nonoperating Revenues (Expenses) | 90,074 |
| Loss Before Transfers | (242,138) |
| Transfers (out) | (86,403) |
| Change in Net Position | (328,541) |
| Beginning net position | 8,414,864 |
| Ending Net Position | \$ 8,086,323 |

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS (Page 1 of 2)

For the Year Ended September 30, 2015

| | <u>Water, Sewer & Sanitation</u> |
|--|--|
| <u>Cash Flows from Operating Activities</u> | |
| Receipts from customers | \$ 793,314 |
| Payments to employees | (92,300) |
| Payments to suppliers | (612,447) |
| Net Cash Provided by Operating Activities | <u>88,567</u> |
| <u>Cash Flows from Noncapital Financing Activities</u> | |
| Transfers (out) | (125,300) |
| Net Cash Provided (Used) by Noncapital Financing Activities | <u>(125,300)</u> |
| <u>Cash Flows from Capital and Related Financing Activities</u> | |
| Capital purchases | (26,091) |
| Net Cash (Used) by Capital and Related Financing Activities | <u>(26,091)</u> |
| <u>Cash Flows from Investing Activities</u> | |
| Interest | 280 |
| Net Cash Provided by Investing Activities | <u>280</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | (62,544) |
| Beginning cash and cash equivalents | <u>286,153</u> |
| Ending Cash and Cash Equivalents | <u><u>\$ 223,609</u></u> |
| <u>Schedule of Non-Cash Capital and Related Financing Activities:</u> | |
| Contributions of capital assets | \$ 89,794 |
| Transfer of assets constructed by governmental activities | \$ 38,898 |

See Notes to Financial Statements.

City of Montgomery, Texas

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS (Page 2 of 2)

For the Year Ended September 30, 2015

| | <u>Water, Sewer & Sanitation</u> |
|--|--|
| <u>Reconciliation of Operating Income</u> | |
| <u>to Net Cash Provided by Operating Activities</u> | |
| Operating Income | \$ (332,212) |
| Adjustments to reconcile operating income to net cash provided: | |
| Depreciation | 341,680 |
| Changes in Operating Assets and Liabilities: | |
| (Increase) Decrease in: | |
| Accounts receivable | 32,288 |
| Increase (Decrease) in: | |
| Accounts payable and accrued liabilities | 30,713 |
| Customer deposits | 10,385 |
| Deferred outflows - pension contributions | (821) |
| Deferred outflows - investment earnings | (901) |
| Deferred inflows - pension (gains) losses | 4,126 |
| Due to other funds | 7,684 |
| Due to other governments | 1,116 |
| Net pension liability | (5,491) |
| Net Cash Provided by Operating Activities | <u><u>\$ 88,567</u></u> |

See Notes to Financial Statements.

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS

September 30, 2015

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The City of Montgomery, Texas (the "City") was incorporated under the laws of the State of Texas in 1935.

The City operates under a "General Law" City which provides for a "Mayor-Council" form of government. The City Council is the principal legislative body of the City. The City Administrator is appointed by a majority vote of the City Council and is responsible to the Council for the administration of all affairs of the City. The City Administrator is responsible for the appointment and removal of department directors and employees, supervision and control of all City departments, and preparation of the annual budget. The City provides the following services: general administration, public safety, public works, water services, and sewer services.

The City is an independent political subdivision of the State of Texas governed by an elected council and a mayor and is considered a primary government. Its activities are not considered a part of any other governmental or other type of reporting entity. As required by generally accepted accounting principles, these basic financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations, or functions as part of the City's financial reporting entity. The component units, although legally separate, are considered part of the reporting entity. No other entities have been included in the City's reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations or functions in the City's financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the City is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the City's financial reporting entity status is that of a primary government are that it has a separately elected governing body; it is legally separate; and is fiscally independent of other state and local governments. Additionally prescribed criteria under generally accepted accounting principles include considerations pertaining to organizations for which the primary government is financially accountable, and considerations pertaining to organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Based on this, and based upon their significant financial and operational relationships to the City, the City has a discrete component unit, as follows:

Discrete Component Unit

Montgomery Economic Development Corporation (4B fund)

On December 14, 1995, the City incorporated the "Montgomery Industrial Development Corporation"

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2015

("MIDC"). In July 2013, the name was changed to Montgomery Economic Development Corporation ("MEDC"). The purpose of this non-profit corporation is to promote economic development within the City and the State of Texas in order to eliminate unemployment and underemployment, and to promote and encourage employment and the public welfare of, for, and on behalf of the City, and for improving the assessed valuations through the promotion of: (a) existing business enterprise expansion and retention and (b) new business enterprise development and attraction by developing, implementing, providing and financing projects. A one-half of one percent City sales tax is designated for this purpose.

B. Financial Statement Presentation

These financial statements include implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Requirements of the statement include the following:

- A Management's Discussion and Analysis (MD&A) section providing an analysis of the City's overall financial position and results of operations;
- Financial statements prepared using full accrual accounting for all of the City's activities;
- A change in the fund financial statements to focus on the major funds.

GASB Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net position and a statement of activities. It requires the classification of net position into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- **Net investment in capital assets**—This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted**—This component of net position consists of constraints placed on net position use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, laws or regulation of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted**—This component of net position consists of net position that does not meet the definition of "restricted" or "invested in capital assets, net of related debt."

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

C. Government-Wide and Fund Financial Statements

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

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include charges paid by the recipients of goods or services offered by the programs and grants that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, such as taxes and investment earnings, are presented as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. In the fund financial statements, the accounts of the City are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses, as appropriate. The government reports the following governmental funds:

Governmental Funds

Governmental funds are those funds through which most governmental functions are typically financed and focuses on the sources, uses and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Fund liabilities are assigned to the fund from which they will be liquidated. The City reports the difference between its governmental fund assets and its liabilities and deferred inflows of resources as fund balance.

General Fund

The General Fund is the main operating fund of the City. The general fund is used to account for all financial transactions not properly includable in other funds. The principal sources of revenues include local property taxes, sales and franchise taxes, licenses and permits, fines and forfeitures, and charges for services. Expenditures include general government, public safety (police and municipal court), and public works. The general service fund is considered a major fund for reporting purposes.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

Debt Service Fund

The debt service fund is used to account for the payment of interest and principal on all general obligation bonds and other long-term debt of governmental funds. The primary source of revenue for debt service is local property taxes. The debt service fund is considered a major fund for reporting purposes.

Capital Projects Fund

The capital projects fund is used to account for the expenditures of resources accumulated from the sale of bonds and related interest earnings, contributed capital or transfers from other funds, other than those recorded in the enterprise funds for acquisition of capital facilities. The capital projects fund is considered a nonmajor fund for reporting purposes.

Special Revenue Funds

Special Revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts and major capital projects) that are legally restricted or designated for specified activities. The City's Special Revenue funds include the Hotel Tax Fund, and the Police and Court Fund. These funds are financed through taxes (Hotel Tax Fund) or forfeitures and fees (Police and Court fund). These funds are considered nonmajor funds for reporting purposes.

Proprietary Fund Types

Proprietary funds are used to account for activities that are similar to those often found in the private sector. All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business activities are accounted for through proprietary funds. The measurement focus is on determination of net income, financial position, and cash flows. Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues include charges for services. Operating expenses include costs of materials, contracts, personnel, and depreciation. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Proprietary fund types follow GAAP prescribed by the Governmental Accounting Standards Board (GASB) and all financial Accounting Standards Board's standards issued prior to November 30, 1989. Subsequent to this date, the City accounts for its enterprise funds as presented by GASB. The proprietary fund types used by the City include enterprise funds.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

The government reports the following major enterprise fund:

Water, Sewer, and Sanitation Fund

This fund is used to account for the provision of water, sewer & garbage services to the residents of the City. Activities of the fund include administration, operations and maintenance of the water production and distribution system, water collection and treatment systems, and contract garbage services. The fund also accounts for the accumulation of resources for and the payment of long-term debt, principal and interest. All costs are financed through charges to utility customers with rates reviewed regularly and adjusted if necessary to ensure integrity of the fund.

D. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Measurement focus refers to what is being measured and basis of accounting refers to when transactions are recorded in the financial records and reported on the financial statements and relates to the timing of the measurement made, regardless of the measurement focus applied.

The government-wide statements and fund financial statements for proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net position and the operating statements present increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses in the accounting period in which they are incurred and become measurable. Proprietary fund equity consists of net position. Proprietary fund-type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

All governmental funds and component units are reported using the current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they are susceptible to accrual (i.e., when they are measurable and available).

Measurable means the amount of the transaction can be determined and available means collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues available if they are collected within 60 days of the end of the current period. Property taxes, sales taxes, franchise taxes, and interest associated with the current period are all considered to be susceptible to accrual and so have been recognized as revenues of the current period. Other receipts and other taxes become measurable and available when cash is received by the government and are recognized as revenue at that time.

Generally, the effect of interfund activity has been eliminated from the government-wide financial statements.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

E. Estimates

The preparation of financial statements, in conformity with 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.

F. Assets, liabilities, deferred inflows/outflows, and net position/fund balance

1. Deposits and Investments

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

In accordance with GASB Statement No. 31, *Accounting and Reporting for Certain Investments and External Investment Pools*, the City reports all investments at fair value, except for "money market investments" and "2a7-like pools." Money market investments, which are short-term highly liquid debt instruments that may include U.S. Treasury and agency obligations, are reported at amortized costs. Investment positions in external investment pools that are operated in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940, such as TexSTAR, are reported using the pools' share price.

The City has adopted a written investment policy regarding the investment of its funds as defined in the Public Funds Investment Act, Chapter 2256, of the Texas Governmental Code.

In summary, the City is authorized to invest in the following:

- Direct obligations of the U.S. Government
- Fully collateralized certificates of deposit and money market accounts
- Statewide investment pools

2. Receivables and Interfund Transactions

Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the year are referred to as either "interfund receivables/payables" (i.e., the current portion 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" in the fund financial statements. If the transactions are between the primary government and its component unit, these receivables and payables are classified as "due to/from

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

component unit/primary government.” Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances.”

Advances between funds are offset by a fund balance reserve account in the applicable governmental fund to indicate they are not available for appropriation and are not expendable available financial resources.

All trade receivables are shown net of any allowance for uncollectible amounts.

3. Property Taxes

Property taxes are levied by October 1 on the assessed value listed as of the prior January 1 for all real and business personal property in conformity with Subtitle E, Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. Penalties are calculated after February 1 up to the date collected by the government at the rate of 6% for the first month and increased 1% per month up to a total of 12%. Interest is calculated after February 1 at the rate of 1% per month up to the date collected by the government. Under state law, property taxes levied on real property constitute a lien on the real property which cannot be forgiven without specific approval of the State Legislature. The lien expires at the end of twenty years. Taxes levied on personal property can be deemed uncollectible by the City.

4. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government, as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Interest costs incurred in connection with construction of enterprise fund capital assets are capitalized when the effects of capitalization materially impact the financial statements.

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.

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2015

Property, plant, and equipment of the primary government, as well as the component units, are depreciated using the straight-line method over the following estimated useful years.

| Asset Description | Estimated Useful Life |
|----------------------------|------------------------------|
| Vehicles | 5 to 7 years |
| Furniture and equipment | 5 to 20 years |
| Infrastructure | 10 to 40 years |
| Water and sewer system | 20 to 40 years |
| Buildings and improvements | 20 years |

5. Deferred outflows/inflows of resources

In addition to assets, the statement of net 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.

An example is a deferred charge on refunding reported in the government-wide statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

In addition to liabilities, the statement of net 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 government has only one type of item, which arises only under a modified accrual basis of accounting that qualifies for reporting in this category. Accordingly, the item, unavailable revenue, is reported only in the governmental funds balance sheet.

6. Net Position Flow Assumption

Sometimes the government will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the government-wide statements, a flow assumption must be made about the order in which the resources are considered to be applied.

It is the government's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, *Continued*
September 30, 2015

7. Fund Balance Flow Assumptions

Sometimes the government will fund outlays for a particular purpose from both restricted and unrestricted resources (the total of committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the governmental fund financial statements a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted fund balance to have been depleted before using any of the components of unrestricted fund balance. Further, when the components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first, followed by assigned fund balance. Unassigned fund balance is applied last.

8. Fund Balance Policies

Fund balance of governmental funds is reported in various categories based on the nature of any limitations requiring the use of resources for specific purposes. The government itself can establish limitations on the use of resources through either a commitment (committed fund balance) or an assignment (assigned fund balance).

The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. The governing council is the highest level of decision-making authority for the government that can, by adoption of an ordinance prior to the end of the fiscal year, commit fund balance.

Once adopted, the limitation imposed by the ordinance remains in place until a similar action is taken (the adoption of another ordinance) to remove or revise the limitation.

Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as committed. The governing body (council) has by resolution authorized the finance director to assign fund balance. The council may also assign fund balance as it does when appropriating fund balance to cover a gap between estimated revenue and appropriations in the subsequent year's appropriated budget. Unlike commitments, assignments generally only exist temporarily. In other words, an additional action does not normally have to be taken for the removal of an assignment. Conversely, as discussed above, an additional action is essential to either remove or revise a commitment.

9. Compensated Absences

The City maintains formal programs for vacation and sick leave. The City's full-time, permanent employees are granted vacation pay benefits in varying amounts to specified maximums depending on tenure with the City. The City's personnel policy permits its full-time, permanent employees to accumulate earned but unused vacation pay benefits. Upon separation with the City,

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, *Continued*
September 30, 2015

employees will be paid for their accrued and unused vacation pay benefits.

Sick leave accrues to full-time, permanent employees to specified maximums, but upon separation with the City, employees will not be paid for accumulated sick leave.

The liability for compensated absences reported in the government-wide and proprietary fund statements consist of unpaid, accumulated vacation balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Vested or accumulated vacation leave and compensated leave of government-wide and proprietary funds are recognized as an expense and liability of those funds as the benefits accrue to employees.

It is the City's policy to liquidate compensated absences with future revenues rather than with currently available expendable resources. Accordingly, the City's governmental funds recognize accrued compensated absences when it is paid.

10. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities statement of net position. The long-term debt consists primarily of bonds payable and accrued compensated absences.

Long-term debt for governmental funds is not reported as liabilities in the fund financial statements until due. The debt proceeds are reported as other financing sources, net of the applicable premium or discount and payments of principal and interest reported as expenditures. In the governmental fund types, issuance costs, even if withheld from the actual net proceeds received, are reported as debt service expenditures. However, claims and judgments paid from governmental funds are reported as a liability in the fund financial statements only for the portion expected to be financed from expendable available financial resources.

Long-term debt and other obligations, financed by proprietary funds, are reported as liabilities in the appropriate funds. For proprietary fund types, bond premiums, discounts and issuance costs are deferred and amortized over the life of the bonds using the effective interest method, if material. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges.

Assets acquired under the terms of capital leases 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 general fund. Lease payments representing both principal and interest are recorded as expenditures in the general fund upon

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

payment with an appropriate reduction of principal recorded in the government-wide financial statements.

G. Revenues and expenditures/expenses

1. Program revenues

Amounts reported as *program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions (including special assessments) that are restricted to meeting the operational or capital requirements of a particular function or segment. All taxes, including those dedicated for specific purposes, and other internally dedicated resources are reported as general revenues rather than as program revenues.

2. Proprietary funds operating and nonoperating revenues and expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations.

The principal operating revenues of the utility fund are charges to customers for sales and services. The utility fund also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

A. Explanation of certain differences between the governmental fund balance sheet and the government-wide statement of net position.

The governmental fund balance sheet includes reconciliation between *fund balance-total governmental funds* and *net position-governmental activities* as reported in the government-wide statement of net position. One element of that reconciliation explains that long-term liabilities, including bonds, are not due and payable in the current period and, therefore, are not reported in the funds.

B. Explanation of certain differences between the governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities.

The governmental fund statement of revenues, expenditures, and changes in fund balances includes a reconciliation between net changes in fund balances – total governmental funds and changes in net position of governmental states that, “the issuance of long-term debt (e.g., bonds) 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. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities.”

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

II. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP) for the general, debt service, special revenue, and utility funds. The original budget is adopted by the City Council prior to the beginning of the year. The legal level of control as defined by the City Charter is the function level. No funds can be transferred or added to a budgeted item without Council approval. Appropriations lapse at the end of the year. Several supplemental budget appropriations were made during the year.

A. Deficit Net Position

As of the end of the year, governmental activities reported deficit net position of \$2,996,114. This deficit is due to business-type assets financed with debt paid by governmental activities. The deficit will be resolved as the debt balance is paid and overall net position improves.

B. Expenditures Over Appropriations

For the year ended, expenditures exceeded appropriations at the legal level of control as follows:

General Fund:

| | |
|-----------------------------|----------|
| Police department | \$22,437 |
| Municipal court | \$43,731 |
| Sales tax withheld by state | \$68,051 |

Debt Service Fund

| | |
|---------------------------------------|-----------|
| Bond issuance costs | \$38,430 |
| Payment to refunded bond escrow agent | \$816,164 |

The City has implemented procedures to ensure budgetary compliance. No expenditure can be made unless there is a budget available or an approved budget amendment has been submitted. Department head and management will review the budget variances on a regular basis and the budget will be amended if necessary.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

As of September 30, 2015, the primary government had the following investments:

| Investment Type | Fair Value | Weighted Average Maturity (Years) |
|-------------------------------------|------------|---|
| Certificates of deposit | \$ 300,000 | 0.14 |
| Total fair value | \$ 300,000 | |
| Portfolio weighted average maturity | | |

As of September 30, 2015, the Montgomery EDC had the following investments:

| Investment Type | Fair Value | Weighted Average Maturity (Years) |
|-------------------------------------|------------|---|
| Certificates of deposit | \$ 100,000 | 0.16 |
| Total fair value | \$ 100,000 | |
| Portfolio weighted average maturity | | |

Interest rate risk In accordance with its investment policy, the City manages its exposure to declines in fair values by limiting the weighted average of maturity not to exceed five years; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations; monitoring credit ratings of portfolio position to assure compliance with rating requirements imposed by the Public Funds Investment Act; and invest operating funds primarily in short-term securities or similar government investment pools.

Credit risk The City's investment policy limits investments to obligations of the United States, State of Texas, or their agencies and instrumentalities with an investment quality rating of not less than "A" or its equivalent, by a nationally recognized investment rating firm. Other obligations must be unconditionally guaranteed (either express or implied) by the full faith and credit of the United States Government or the issuing U.S. agency and investment pools with an investment quality not less than AAA or AAA-m, or equivalent, by at least one nationally recognized rating service. As of September 30, 2015, the City's investment in TexPool was rated AAAM by Standard & Poor's.

Custodial credit risk – deposits In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. State statutes require that all deposits in financial institutions be insured or fully collateralized by U.S. government obligations or its agencies and instrumentalities or direct obligations of Texas or its agencies and instrumentalities that have a market

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

value of not less than the principal amount of the deposits. As of September 30, 2015, the market values of pledged securities and FDIC exceeded bank balances.

Custodial credit risk – investments For an investment, this is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City's investment policy requires that it will seek to safekeeping securities at financial institutions, avoiding physical possession. Further, all trades, where applicable, are executed by delivery versus payment to ensure that securities are deposited in the City's safekeeping account prior to the release of funds.

TexPool

The Texas Local Government Investment Pool ("TexPool") has been organized in conformity with the Interlocal Cooperation Act, Chapter 791 of the Texas Government Code, and the Public Funds Investment Act, Chapter 2256 of the Texas Government Code. These two acts provide for the creation of public funds investment pools and permit eligible governmental entities to jointly invest their funds in authorized investments. TexPool was established as a trust company with the Treasurer of the State of Texas as trustee, segregated from all other trustees, investments, and activities of the trust company. The State Comptroller of Public Accounts exercises oversight responsibility over TexPool. Oversight includes the ability to significantly influence operations, designation of management, and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The advisory board members review the investment policy and management fee structure. The Comptroller of Public Accounts is the sole officer, director and shareholder of the Texas Treasury Safekeeping Trust Company, which is authorized to operate TexPool. Pursuant to the TexPool Participation Agreement, administrative and investment services to TexPool are provided by Lehman Brothers Inc. and Federated Investors, Inc. under an agreement with the Comptroller, acting on behalf of the Trust Company.

The City reports all investments at fair value, except for "money market investments" and "2a-7-like pools." Money market investments, which are short-term highly liquid debt instruments that may include U.S. Treasury and agency obligations, are reported at amortized costs. Investment positions in external investment pools that are operated in a manner consistent with the Security and Exchange Commissions (SEC) Rule 2a-7 of the Investment Company Act of 1940, such as TexPool, are reported using the pools' share price. Such investments do not have interest rate risk disclosure requirements. The overall TexPool investment pool has a weighted average maturity of .44 years. The City is allowed to withdraw its funds from TexPool at anytime. Therefore, the City's deposits in TexPool have been included with cash. As of September 30, 2015, the primary government had \$496,199 in deposits with TexPool. As of September 30, 2015, the Montgomery EDC had \$232,579 in deposits with TexPool.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

B. Receivables

The following comprise receivable balances of the primary government at year end:

| | General | Debt Service | Water, Sewer & Sanitation | Total |
|----------------|-------------------|---------------------|--|-------------------|
| Property taxes | \$ 6,781 | \$ 11,301 | \$ - | \$ 18,082 |
| Sales tax | 230,554 | - | - | 230,554 |
| Accounts | - | - | 139,612 | 139,612 |
| Other | 2,008 | - | - | 2,008 |
| Allowance | - | - | (27,217) | (27,217) |
| | <u>\$ 239,343</u> | <u>\$ 11,301</u> | <u>\$ 112,395</u> | <u>\$ 390,256</u> |

C. Capital Assets

A summary of changes in governmental activities capital assets for the year end was as follows:

| | Beginning Balances | Increases | Decreases/ Reclassifications | Ending Balances |
|--|-------------------------------|---------------------------|---|----------------------------|
| Capital assets, not being depreciated: | | | | |
| Land | \$ 768,985 | \$ | \$ | \$ 768,985 |
| Construction in progress | 20,750 | 20,750 | (41,500) | - |
| Total capital assets not being depreciated | <u>789,735</u> | <u>20,750</u> | <u>(41,500)</u> | <u>768,985</u> |
| Capital assets, being depreciated: | | | | |
| Infrastructure | 1,268,119 | - | - | 1,268,119 |
| Buildings and improvements | 904,940 | - | 41,500 | 946,440 |
| Vehicles | 514,406 | 131,371 | - | 645,777 |
| Furniture and fixtures | 377,769 | 7,896 | - | 385,665 |
| Total capital assets being depreciated | <u>3,065,234</u> | <u>139,267</u> | <u>41,500</u> | <u>3,246,001</u> |
| Less accumulated depreciation | | | | |
| Infrastructure | (220,522) | (42,271) | - | (262,793) |
| Buildings and improvements | (303,975) | (47,322) | - | (351,297) |
| Vehicles | (358,354) | (87,062) | - | (445,416) |
| Furniture and fixtures | (261,522) | (25,633) | - | (287,155) |
| Total accumulated depreciation | <u>(1,144,373)</u> | <u>(202,288)</u> | <u>-</u> | <u>(1,346,661)</u> |
| Net capital assets being depreciated | <u>1,920,861</u> | <u>(63,021)</u> | <u>41,500</u> | <u>1,899,340</u> |
| Total Capital Assets | <u><u>\$ 2,710,596</u></u> | <u><u>\$ (42,271)</u></u> | <u><u>\$ -</u></u> | <u><u>\$ 2,668,325</u></u> |

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

Depreciation was charged to governmental functions as follows:

| | |
|---|-------------------|
| General government | \$ 63,050 |
| Public safety | 88,344 |
| Public works | 50,894 |
| Total Governmental Activities Depreciation Expense | \$ 202,288 |

A summary of changes in business-type activities capital assets for the year end was as follows:

| | Beginning Balances | Increases | Decreases/ Reclassifications | Ending Balances |
|--|-------------------------------|---------------------|---|----------------------------|
| Capital assets, not being depreciated: | | | | |
| Land | \$ 66,581 | \$ - | \$ - | \$ 66,581 |
| Construction in progress | 978,044 | 32,678 | (1,002,921) | 7,801 |
| Total capital assets not being depreciated | 1,044,625 | 32,678 | (1,002,921) | 74,382 |
| Capital assets, being depreciated: | | | | |
| Infrastructure | 9,867,297 | 122,106 | 1,002,921 | 10,992,324 |
| Furniture and equipment | 173,642 | - | - | 173,642 |
| Vehicles | 102,404 | - | - | 102,404 |
| Total capital assets being depreciated | 10,143,343 | 122,106 | 1,002,921 | 11,268,370 |
| Less accumulated depreciation | | | | |
| Infrastructure | (2,926,099) | (322,674) | - | (3,248,773) |
| Furniture and equipment | (135,274) | (3,531) | - | (138,805) |
| Vehicles | (55,977) | (15,475) | - | (71,452) |
| Total accumulated depreciation | (3,117,350) | (341,680) | - | (3,459,030) |
| Net capital assets being depreciated | 7,025,993 | (219,574) | 1,002,921 | 7,809,340 |
| Total Capital Assets | \$ 8,070,618 | \$ (186,896) | \$ - | \$ 7,883,722 |

Depreciation was charged to business-type activities as follows:

| | |
|--|-------------------|
| Water | \$ 246,418 |
| Sewer | 95,262 |
| Total Business-Type Activities Depreciation Expense | \$ 341,680 |

D. Customer Deposits

The City had customer deposits of \$51,498 in the proprietary fund as of year-end. The City requires a \$250 refundable deposit for all new utility customers. This amount will be refunded when the customer terminates utility service with the City.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

E. Long-term Debt

The following is a summary of changes in the City's total governmental long-term liabilities for the year ended. In general, the City uses the debt service fund to liquidate governmental long-term liabilities.

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending Balance</u> | <u>Amounts Due within One Year</u> |
|--|------------------------------|-------------------|-----------------------|---------------------------|--|
| Governmental Activities: | | | | | |
| General Obligation Refunding Bond | \$ 2,680,000 | \$ 845,000 | \$ (100,000) | \$ 3,425,000 | \$ 180,000 |
| Tax & Revenue Certificates of Obligations | 4,605,000 | - | # (955,000) | 3,650,000 | 115,000 |
| Issuance Premiums | 137,592 | - | (5,827) | 131,765 | |
| Other liabilities: | | | | | |
| Sales Tax Due to State Comptroller | 182,572 | - | (68,051) | 114,521 | 59,420 |
| Compensated absences | 60,758 | 29,558 | (48,293) | 42,023 | 37,821 |
| Total Governmental Activities | <u>\$ 7,665,922</u> | <u>\$ 874,558</u> | <u>\$ (1,177,171)</u> | <u>\$ 7,363,309</u> | <u>\$ 392,241</u> |
| Long-term liabilities due in more than one year | | | | <u>\$ 6,971,068</u> | |
| Business-Type Activities: | | | | | |
| Other liabilities: | | | | | |
| Compensated absences | 5,812 | 3,180 | (5,241) | 3,751 | 3,376 |
| Total Business-Type Activities | <u>\$ 5,812</u> | <u>\$ 3,180</u> | <u>\$ (5,241)</u> | <u>\$ 3,751</u> | <u>\$ 3,376</u> |

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly, are not reported as fund liabilities in the governmental funds. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending Balance</u> | <u>Amounts Due within One Year</u> |
|--|------------------------------|------------------|-------------------|---------------------------|--|
| Montgomery EDC | | | | | |
| Other liabilities: | | | | | |
| Sales Tax Due to State Comptroller | \$ 60,857 | \$ - | \$ (22,684) | \$ 38,173 | \$ 19,807 |
| Long-term liabilities due in more than one year | | | | <u>\$ 18,366</u> | |

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

Long-term debt at year end was comprised of the following debt issues:

| Description | Interest Rates | Original Balance | Current Balance |
|---|-------------------|---------------------|---------------------|
| Governmental Activities: | | | |
| 2012 General obligation refunding bonds | 2.00 - 4.00% | \$ 2,830,000 | \$ 2,580,000 |
| 2012 Tax & Revenue certificates of obligation | 3.00 - 3.50% | 3,760,000 | 3,650,000 |
| 2015 General obligation refunding bonds | 0.85-2.80% | 845,000 | 845,000 |
| Total Governmental Activities | | \$ 7,435,000 | \$ 7,075,000 |

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

The annual requirements to amortize governmental activities debt issues outstanding at year ending were as follows:

| Year ending September 30, | 2012 G.O. Bonds | | Governmental Activities 2012 Tax & Revenue COs | | 2015 G.O. Refunding Bonds | |
|------------------------------|---------------------|-------------------|---|---------------------|---------------------------|-------------------|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2016 | \$ 105,000 | \$ 79,468 | \$ 115,000 | \$ 119,501 | \$ 75,000 | \$ 16,841 |
| 2017 | 105,000 | 77,368 | 120,000 | 115,976 | 80,000 | 16,023 |
| 2018 | 105,000 | 75,268 | 120,000 | 112,376 | 80,000 | 14,903 |
| 2019 | 105,000 | 73,103 | 125,000 | 108,701 | 85,000 | 13,518 |
| 2020 | 110,000 | 70,750 | 130,000 | 104,876 | 85,000 | 11,903 |
| 2021 | 115,000 | 68,075 | 130,000 | 100,976 | 80,000 | 11,173 |
| 2022 | 115,000 | 65,200 | 135,000 | 97,001 | 85,000 | 8,294 |
| 2023 | 120,000 | 62,112 | 140,000 | 92,876 | 90,000 | 6,170 |
| 2024 | 125,000 | 58,744 | 145,000 | 88,601 | 90,000 | 3,853 |
| 2025 | 130,000 | 55,076 | 145,000 | 84,251 | 95,000 | 1,330 |
| 2026 | 130,000 | 51,176 | 150,000 | 79,451 | - | - |
| 2027 | 135,000 | 47,032 | 155,000 | 74,113 | - | - |
| 2028 | 140,000 | 42,563 | 160,000 | 68,600 | - | - |
| 2029 | 145,000 | 37,569 | 165,000 | 62,913 | - | - |
| 2030 | 155,000 | 31,944 | 170,000 | 57,051 | - | - |
| 2031 | 110,000 | 26,975 | 175,000 | 51,013 | - | - |
| 2032 | 115,000 | 22,756 | 180,000 | 44,800 | - | - |
| 2033 | 125,000 | 18,100 | 190,000 | 38,325 | - | - |
| 2034 | 125,000 | 13,100 | 190,000 | 31,675 | - | - |
| 2035 | 130,000 | 8,000 | 195,000 | 24,938 | - | - |
| 2036 | 135,000 | 2,700 | 200,000 | 18,026 | - | - |
| 2037 | - | - | 205,000 | 10,938 | - | - |
| 2038 | - | - | 210,000 | 3,675 | - | - |
| | <u>\$ 2,580,000</u> | <u>\$ 987,079</u> | <u>\$ 3,650,000</u> | <u>\$ 1,590,653</u> | <u>\$ 845,000</u> | <u>\$ 104,008</u> |

Series 2012 – General Obligation Refunding Bond - the bond is secured by water and sewer revenue and is repayable with property tax revenue. The proceeds were used to refund the City's Series 2005A and Series 2005B Certificates of Obligation.

Series 2012 Tax and Revenue Certificate of Obligation - the bond is secured by water and sewer revenues and is repayable with property tax revenue. The proceeds were used for construction of and improvements to the facilities and equipment of the City's water and sewer system.

Series 2015 General Obligation Refunding Bond - the bond is secured by water and sewer revenues and is repayable with property tax revenue. The proceeds were used to refund an existing bond that was used for improvements to the City's water and sewer system.

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2015

Sales Tax Overpayments

During the year ended September 30, 2012, the City received a notice from the Texas State Comptroller informing them that two businesses had erroneously reported their location to be within City limits. As a result, the City received more sales tax revenue than it should have. The City's sales tax will be reduced \$4,500 per month until this is corrected. The City received an additional notification from the State Comptroller that further overpayments were made totaling \$146,938. The City opted to have the State Comptroller withhold an additional amount of \$3,061 monthly for 48 months until the balance is paid. This overpayment was split between the City and the Montgomery EDC which also receives the sales tax revenue from the state.

The total balance of sales tax overpayments due to the State Comptroller for the year ended September 30, 2015 was \$114,521 for the City and \$37,901 for the Montgomery EDC.

F. Advanced Refunding Bond

The City issued \$845,000 in bonds with interest rates ranging from 0.85-2.80%. The proceeds were used to refund \$845,000 of outstanding 2005 Tax & Revenue certificates of obligations which had an interest rate of 4.89 – 5.740%. The net proceeds of 845,000 (after payment of \$38,430 in underwriting fees and other issuance costs) were used to refund the original bond holders. As a result, the liability for those bonds has been removed from the statement of net position. The difference between the reacquisition price and the net carrying amount of the old debt is \$6,164. This difference is being charged to operations through the year 2025 using the effective-interest method. The result is a reduction in total debt service payments over 10 years of \$249,562 and to obtain an economic gain of \$165,754.

G. Interfund Transactions

Transfers between the primary government funds during the 2015 year were as follows:

| Transfer out | Transfer In | Amount |
|---------------------------|--------------|------------|
| Nonmajor Police and Court | General | 2,880 |
| Water & Sewer | Debt Service | 125,300 |
| | | \$ 128,180 |

Amounts transferred between funds relate to amounts collected to pay debt and to fund various capital projects. During the course of the year, assets constructed by the City's Capital Projects fund transferred assets to the Water & Sewer fund in the amount of \$38,898.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

The compositions of interfund balances as of year-end were as follows:

| <u>Funds</u> | <u>Due from</u> | <u>Due to</u> |
|----------------------------|------------------|------------------|
| General: | | |
| Water & Sewer | \$ 8,409 | \$ - |
| Debt Service | - | 16,487 |
| Nonmajor Police & Court | | 4,090 |
| Debt Service: | | |
| General | 16,487 | - |
| Special Revenue | | |
| General | 4,090 | |
| Water, Sewer & Sanitation: | | |
| General | - | 8,409 |
| | <u>\$ 28,986</u> | <u>\$ 28,986</u> |

Amounts recorded as “due to/from” are considered to be temporary loans and will be repaid during the following year.

IV. 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 over 2,800 other entities in the Texas Municipal League’s Intergovernmental Risk Pools. 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.

The City uses a number of approaches to decrease risks and protect against losses to the City, including internal practices, employee training, and a code of ethics, which all employees are required to acknowledge

The City owns and operates motor vehicles and may provide such vehicle to employees for business use during the course and scope of their employment. The City is insured as to its own property losses, and the liability of loss to others.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, *Continued*
September 30, 2015

B. Contingent Liabilities

Amounts received or receivable 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.

The City participates in grant programs which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City had not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable may be impaired.

In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying basic financial statements for such contingencies.

C. Commitments

In 2011, the City entered into an Interlocal Agreement (Agreement #1) with the City of Conroe for the City of Conroe's provision of fleet maintenance services for vehicles owned and operated by the City. This Agreement #1 is automatically renewed, unless explicitly terminated by the contract participants. Payments are made to the City of Conroe in amounts determined by the maintenance and related services as provided by the City of Conroe according to the agreement.

In 2011, the City entered into an Interlocal Agreement (Agreement #2) with Montgomery County, Texas for the purpose of providing fire code enforcement to the City by the Montgomery County, Texas Fire Marshal. This Agreement #2 is automatically renewed, unless explicitly terminated by the contract participants. There is no charge to the City for this service.

In 2013, the City entered into an Interlocal Agreement (Agreement #3) with Montgomery County, Texas for the purpose of the County providing construction, repair, and maintenance of public roads, right of ways, drainage ditches, parking lots, and other like facilities owned or administered by the City. This Agreement #3 is automatically renewed, unless explicitly terminated by the contract participants. Payments are made to the City of Conroe in amounts determined by the maintenance and related services as provided by Montgomery County, Texas according to the agreement.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

D. Agreements

Following is a summary of Development (Escrow) Agreements:

#1 Development: Lone Star Parkway Utilities - Developers: Philip LeFevre, Holly LeFevre, LC Acquisitions, Ltd., Virgin Development III, LP, Grandview Development, Inc., and MC Acquisitions, Ltd.

On January 23, 2007, the City entered into a 15-year term development agreement (the "Agreement") with Philip LeFevre, Holly LeFevre, LC Acquisitions, Ltd., Virgin Development III, LP, Grandview Development, Inc., and MC Acquisitions, Ltd., (the "Developers"). The Developers intend and propose to develop property (the "Property") in the City's extraterritorial jurisdiction for residential, commercial and retail use. As part of the Agreement, the Developers have agreed to convey to the City the Utility Extension Project and submit a petition to the City to annex the Property.

Subject to annexation of the Property and upon final completion of the Utility Extension Project, the City has agreed to make a grant consistent with Article III, Section 52-a of the Texas Constitution, Chapter 380, for reimbursement of the design and construction of public infrastructure (the Utility Extension Project) to the Developer limited to 70 percent of the construction costs. The amount of reimbursement to the Developer is limited to \$395,500 and will be paid from 1% sales and use taxes charged on the taxable sales collected by the City as generated by businesses on the property ("City Sales Tax Revenues"). The term City Sales Tax Revenues does not include sales and use taxes collected but dedicated for property tax reduction or industrial development.

#2 Development: Waterstone Section 1 - Developer: Waterstone on Lake Conroe, Inc.

On August 12, 2008, the City entered into a 10-year term development agreement (the "Agreement") with the Waterstone on Lake Conroe, Inc. (the "Developer"). The Developer intends and proposed to develop property (the "Property") in that is partially in the City and partially in the extraterritorial jurisdiction of the City (the "ETJ Property") for residential, commercial and retail use. As part of the Agreement, the Developer has agreed to accelerate construction of the Utility Extension Project and convey the Project to the City and to submit a petition to the City to annex the ETJ Property into the City.

Subject to annexation of the ETJ Property and upon final completion of the Utility Extension Project, the City has agreed to make a grant consistent with Article III, Section 52-a of the Texas Constitution, Chapter 380, for reimbursement of the design and construction of public infrastructure (the Utility Extension Project) to the Developer limited to 70 percent of the construction costs incurred as well as up to \$12,000 for escrowed funds for the City's engineering expenses.

The amount of reimbursement to the Developer is limited to \$512,000 and will be paid from ad valorem taxes generated from the Property annexed, and collected by the City, above the base

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

property tax (amount of ad valorem taxes levied and collected based on the total appraised value of the property as of January 1, 2008).

#3 Development: Buffalo Crossing - Developer: LeFevre Development Inc.

On February 22, 2011, the City entered into a 10-year term development agreement (the "Agreement") with the LeFevre Development Inc. (the "Developer"). The Developer intends and proposed to develop property (the "Property") in the City for residential, commercial and retail use. As part of the Agreement, the Developer has agreed to accelerate construction of the Utility Extension Project and convey the Project to the City.

Subject to annexation of the Property and upon final completion of the Utility Extension Project, the City has agreed to make a grant consistent with Article III, Section 52-a of the Texas Constitution, Chapter 380, for reimbursement of the design and construction of public infrastructure (the Utility Extension Project) to the Developer a sum of \$148,802.65 paid from ad valorem taxes generated from the Property annexed, and collected by the City, above the base property tax (amount of ad valorem taxes levied and collected based on the total appraised value of the property as of January 1, 2011).

#4 Development: Villas of Mia Lago, Section 1 - Developer: Estates of Mia Lago

On September 13, 2011, the City entered into a development agreement (the "Agreement") with the Estates of Mia Lago, Ltd. (the "Developer"). The Developer intends and proposed to develop property (the "Property") in the City's extraterritorial jurisdiction for primarily high-end single family residential use and a residential assisted living facility. As part of the Agreement, the Developer has agreed to convey to the City the Utility Extension Project and to submit a petition to the City to annex the Property.

Subject to annexation of the Property and upon final completion of the Utility Extension Project, the City has agreed to make a grant consistent with Article III, Section 52-a of the Texas Constitution, Chapter 380, for reimbursement of the design and construction of public infrastructure (the Utility Extension Project) to the Developer limited to 70 percent of the construction costs incurred as well as up to \$5,000 for escrowed funds for the City's engineering expenses. The amount of reimbursement to the Developer is limited to \$132,198 and will be paid from ad valorem taxes generated from the Property annexed, and collected by the City, above the base property tax (amount of ad valorem taxes levied and collected based on the total appraised value of the property as of January 1, 2011).

#5 Development: Hills of Town Creek, Section 1 - Developer: Christian C. Cheatham

On September 27, 2011, the City entered into a development agreement (the "Agreement") with the Christian C. Cheatham (the "Developer") and Montgomery Independent School District (the "School District"). The Developer intends and proposed to develop property (the "Property") in that was recently annexed into the City for primarily high-density, multi-family residential use, with a limited amount of commercial and retail uses. As part of the Agreement, the Developer has agreed to

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

accelerate the construction of the Utility Extension Project and to convey the completed project to the City and petition the City to annex 13.773 acres of land currently located in the extraterritorial jurisdiction of the City (the "ETJ Land"). Other considerations include transfers of property and facilities from the School District and the Developer to the City and transfer of property from the Developer to the School District.

Subject to the final completion of the Utility Extension Project, dedication of the facilities and easements to the City, other considerations, and annexation of the ETJ Land, the City has agreed to make a grant consistent with Article III, Section 52-a of the Texas Constitution, Chapter 380, for reimbursement of the design and construction of public infrastructure (the Utility Extension Project) to the Developer limited to 100 % of the cost to oversize utility lines and 70 percent of the remaining construction costs incurred as well as up to \$16,000 for escrowed funds for the City's engineering expenses. The amount of reimbursement to the Developer is limited to \$400,000 and will be paid from ad valorem taxes generated from the Property annexed, and collected by the City, above the base property tax (amount of ad valorem taxes levied and collected based on the total appraised value of the property as of January 1, 2012).

E. Arbitrage

The Tax Reform Act of 1986 instituted certain arbitrage consisting of complex regulations with respect to issuance of tax-exempt bonds after August 31, 1986. Arbitrage regulations deal with the investment of tax-exempt bond proceeds at an interest yield greater than the interest yield paid to bondholders. Generally, all interest paid to bondholders can be retroactively rendered taxable if applicable rebates are not reported and paid to the Internal Revenue Service at least every five years for applicable bond issues. Accordingly, there is the risk that if such calculations are not performed correctly, a substantial liability to the City could result. The City does anticipate that it will have an arbitrage liability and performs annual calculations to estimate this potential liability. The City will also engage an arbitrage consultant to perform the calculations in accordance with Internal Revenue Service's rules and regulations if indicated.

F. Pension Plans

1. Texas Municipal Retirement Systems

Plan Description

The City of Montgomery participates as one of 860 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. 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

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2015

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.

2. 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 2014</u> | <u>Plan Year 2015</u> |
|--|-----------------------|-----------------------|
| Employee deposit rate | 7.0% | 7.0% |
| Matching ratio (city to employee) | 2 to 1 | 2 to 1 |
| Years required for vesting | 5 | 5 |
| Service retirement eligibility (expressed as age / years of service) | 60/5, 0/20 | 60/5, 0/20 |
| Updated service credit | 0% | 0% |
| Annuity increase (to retirees) | 0% of CPI | 0% of CPI |

Employees covered by benefit terms

At the December 31, 2014 valuation and measurement date, the following employees were covered by the benefit terms:

| | |
|--|----|
| Inactive employees or beneficiaries currently receiving benefits | 8 |
| Inactive employees entitled to but not yet receiving benefits | 24 |
| Active employees | 15 |
| Total | 47 |

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

3. 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. 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 Montgomery were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution rates for the City of Montgomery were 4.13% and 3.0% in calendar years 2015 and 2014, respectively. The City's contributions to TMRS for the year ended September 30, 2015, were \$25,597, and were equal to the required contributions.

4. Net Pension Liability (Asset)

The city's Net Pension Liability (NPL) was measured as of December 31, 2014, 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, 2014 actuarial valuation was determined using the following actuarial assumptions:

| | |
|---------------------------|---|
| Inflation | 3.0% per year |
| Overall payroll growth | 3.0% per year |
| Investment Rate of Return | 7.0%, 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 male rates multiplied by 109% and female rates multiplied by 103%. 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 Disabled Retiree Mortality Table is used, with slight adjustments.

Actuarial assumptions used in the December 31, 2014, valuation were based on the results of actuarial experience studies. The experience study in TMRS was for the period January 1, 2006 through December 31, 2009, first used in the December 31, 2010 valuation. Healthy post-retirement mortality rates and annuity purchase rates were updated based on a Mortality Experience Investigation Study covering 2009 through 2011, and dated December 31, 2013. These

City of Montgomery, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2015

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.

The long-term expected rate of return on pension plan investments is 7.0%. The pension plan's policy in regard to the allocation of invested assets is established and may be amended by the TMRS Board of Trustees. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment 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. The target allocation and best estimates of arithmetic 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 | 17.5% | 4.80% |
| International Equity | 17.5% | 6.05% |
| Core Fixed Income | 30.0% | 1.50% |
| Non-Core Fixed Income | 10.0% | 3.50% |
| Real Return | 5.0% | 1.75% |
| Real Estate | 10.0% | 5.25% |
| Absolute Return | 5.0% | 4.25% |
| Private Equity | 5.0% | 8.50% |
| Total | 100.0% | |

Discount Rate:

The discount rate used to measure the Total Pension Liability was 7.0%. 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.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

Changes in the Net Pension Liability:

| | <u>Total Pension Liability (a)</u> | <u>Plan Fiduciary Net Position (b)</u> | <u>Net Pension Liability (a) – (b)</u> |
|---|--|--|--|
| Balance at 12/31/13 | \$ 762,399 | \$ 881,999 | \$ (119,600) |
| Changes for the year: | | | |
| Service Cost | 81,979 | - | 81,979 |
| Interest | 55,068 | - | 55,068 |
| Difference between expected and actual experience | (54,092) | - | (54,092) |
| Contributions – employer | - | 26,597 | (26,597) |
| Contributions – employee | - | 61,367 | (61,367) |
| Net investment income | - | 50,475 | (50,475) |
| Benefit payments, including refunds of emp. contributions | (33,403) | (33,403) | - |
| Administrative expense | - | (527) | 527 |
| Other changes | - | (43) | 43 |
| Net changes | 49,552 | 104,466 | (54,914) |
| Balance at 12/31/14 | <u>\$ 811,951</u> | <u>\$ 986,465</u> | <u>\$ (174,514)</u> |

Sensitivity of the Net Pension Liability (Asset) to Changes in the Discount Rate

The following presents the net pension asset of the City, calculated using the discount rate of 7.0%, as well as what the City's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.0%) or 1-percentage-point higher (8.0%) than the current rate:

| 1% Decrease 6.00% | Current Single Rate Assumption 7.00% | 1% Increase 8.00% |
|----------------------|---|----------------------|
| \$ (44,846) | \$ (174,514) | \$ (277,146) |

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.

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

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

At September 30, 2015, the City reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|--|
| Differences between expected and actual economic experience | \$ - | \$ 41,262 |
| Difference between projected and investment earnings | 9,012 | - |
| Contributions subsequent to the measurement date | 26,103 | - |
| Total | \$ 35,115 | \$ 41,262 |

The City reported \$26,103 as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date that will be recognized as a reduction of the net pension liability for the year ending September 30, 2015. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| Year ended September 30: | |
|-------------------------------------|------------------|
| 2015 | \$ 10,577 |
| 2016 | 10,577 |
| 2017 | 10,577 |
| 2018 | 519 |
| Thereafter | - |
| Total | \$ 32,250 |

City of Montgomery, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2015

G. Restatement

The City has restated beginning net position within governmental and business type activities due to the adoption of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. The restatement of beginning net position/fund balance is as follows:

| | <u>Governmental Activities</u> | <u>Business-type Activities</u> |
|---|------------------------------------|-------------------------------------|
| Prior year ending net position as reported | \$ (3,364,540) | \$ 8,401,115 |
| Adoption of GASB 68 | 139,839 | 13,749 |
| Restated beginning net position | <u>\$ (3,224,701)</u> | <u>\$ 8,414,864</u> |

H. Subsequent Events

The City has evaluated events and transactions that may impact the financial statements for the year ended September 30, 2015 through February 16, 2016, the date the financial statements were available to be issued and noted there are no subsequent events or transactions that require recognition or disclosure in the financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

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City of Montgomery, Texas
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
GENERAL FUND
For the Year Ended September 30, 2015

| | Original Budget | Amended and Final Budget | Actual | Variance with Final Budget Positive (Negative) |
|--|----------------------------|-------------------------------------|---------------------|---|
| <u>Revenues</u> | | | | |
| Property tax | \$ 144,398 | \$ 146,850 | \$ 153,132 | \$ 6,282 |
| Sales tax | 1,325,000 | 1,347,500 | 1,348,055 | 555 |
| Franchise and local taxes | 63,000 | 75,000 | 73,072 | (1,928) |
| License and permits | 82,800 | 122,800 | 153,565 | 30,765 |
| Intergovernmental | 37,500 | 37,500 | 37,500 | - |
| Fines and forfeitures | 496,180 | 513,530 | 395,058 | (118,472) |
| Interest | 500 | 1,400 | 2,245 | 845 |
| Other | 5,750 | 21,980 | 36,494 | 14,514 |
| Total Revenues | 2,155,128 | 2,266,560 | 2,199,121 | (67,439) |
| <u>Expenditures</u> | | | | |
| Current: | | | | |
| General government | 489,296 | 539,521 | 497,487 | 42,034 |
| Police department | 690,528 | 749,329 | 771,766 | (22,437) * |
| Municipal court | 362,182 | 193,082 | 236,813 | (43,731) * |
| Public works | 477,117 | 486,061 | 468,597 | 17,464 |
| Capital outlay | 266,200 | 301,447 | 191,309 | 110,138 |
| Debt Service | | | | |
| Sales tax withheld by state | - | - | 68,051 | (68,051) * |
| Total Expenditures | 2,285,323 | 2,269,440 | 2,234,023 | 35,417 |
| Revenues Over (Under) Expenditures | (130,195) | (2,880) | (34,902) | (32,022) |
| <u>Other Financing Sources (Uses)</u> | | | | |
| Transfers in | 2,880 | 2,880 | 2,880 | - |
| Total Other Financing Sources | 2,880 | 2,880 | 2,880 | - |
| Net Change in Fund Balance | \$ (127,315) | \$ - | (32,022) | \$ (32,022) |
| Beginning fund balance | | | 1,202,861 | |
| Ending Fund Balance | | | \$ 1,170,839 | |

Notes to Required Supplementary Information

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

*2. Expenditures exceeded appropriations at the legal level of control.

City of Montgomery, Texas

SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS

For the Year Ended December 31, 2014

| | 2014 | ¹ |
|---|---------------------|--------------|
| Total pension liability | | |
| Service cost | \$ 81,979 | |
| Interest | 55,068 | |
| Changes in benefit terms | - | |
| Differences between expected and actual experience | (54,092) | |
| Changes of assumptions | - | |
| Benefit payments, including refunds of participant contributions | (33,403) | |
| Net change in total pension liability | 49,552 | |
| Total pension liability - beginning | \$ 762,399 | |
| Total pension liability - ending (a) | \$ 811,951 | |
| Plan fiduciary net position | | |
| Contributions - employer | \$ 26,597 | |
| Contributions - members | 61,367 | |
| Net investment income | 50,475 | |
| Benefit payments, including refunds of participant contributions | (33,403) | |
| Administrative expenses | (527) | |
| Other | (43) | |
| Net change in plan fiduciary net position | 104,466 | |
| Plan fiduciary net position - beginning | 881,999 | |
| Plan fiduciary net position - ending (b) | \$ 986,465 | |
| Fund's net pension liability (asset) - ending (a) - (b) | \$ (174,514) | |
| Plan fiduciary net position as a percentage of the total pension liability | 121% | |
| Covered employee payroll | \$ 876,672 | |
| Fund's net position as a percentage of covered employee payroll | -19.91% | |

Notes to schedule:

¹ This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten-year trend is compiled, only available information is shown.

City of Montgomery, Texas
SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN
TEXAS MUNICIPAL RETIREMENT SYSTEM
For the Year Ended September 30, 2015

1

| | <u>9/30/2015</u> |
|--|------------------|
| Actuarially determined employer contributions | \$ 26,103 |
| Contributions in relation to the actuarially determined contribution | \$ 26,103 |
| Contribution deficiency (excess) | \$ - |
| Annual covered employee payroll | \$ 918,710 |
| Employer contributions as a percentage of covered employee payroll | 2.84% |

¹ This schedule is presented to illustrate the requirement to show information for ten years. However, until a full ten-year trend is compiled, only available information is shown.

NOTES TO SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN

Valuation Date:

| | |
|-------|---|
| Notes | 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 | 25 years |
| Asset Valuation Method | 10 Year smoothed market; 15% soft corridor |
| Inflation | 3.0% |
| Salary Increases | 3.50% to 12.00% including inflation |
| Investment Rate of Return | 7.00% |
| Retirement Age | Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2010 valuation pursuant to an experience study of the period 2005 - 2009 |
| Mortality | RP2000 Combined Mortality Table with Blue Collar Adjustment with male rates multiplied by 109% and female rates multiplied by 103% and projected on a fully generational basis with scale BB |

Other Information:

| | |
|-------|--|
| Notes | There were no benefit changes during the year. |
|-------|--|

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OTHER SUPPLEMENTARY INFORMATION

City of Montgomery, Texas
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
DEBT SERVICE FUND
For the Year Ended September 30, 2015

| | Original and Final Budget | Actual | Variance with Final Budget Positive (Negative) |
|--|------------------------------|-------------------|---|
| <u>Revenues</u> | | | |
| Property tax | \$ 254,000 | \$ 259,563 | \$ 5,563 |
| Intergovernmental | 117,500 | 117,500 | - |
| Interest | 1,500 | 190 | (1,310) |
| Total Revenues | <u>373,000</u> | <u>377,253</u> | <u>4,253</u> |
| <u>Expenditures</u> | | | |
| Debt Service | | | |
| Principal | 245,000 | 245,000 | - |
| Interest and fiscal charges | 252,114 | 234,703 | 17,411 |
| Bond issuance costs | - | 38,430 | (38,430) * |
| Total Expenditures | <u>497,114</u> | <u>518,133</u> | <u>(21,019)</u> |
| Revenues Over (Under) Expenditures | <u>(124,114)</u> | <u>(140,880)</u> | <u>(16,766)</u> |
| <u>Other Financing Sources (Uses)</u> | | | |
| Transfers in | 125,300 | 125,300 | - |
| Refunding bonds issued | - | 845,000 | 845,000 |
| Payment to refunded bond escrow agent | - | (816,164) | (816,164) * |
| Total Other Financing Sources | <u>125,300</u> | <u>154,136</u> | <u>28,836</u> |
| Net Change in Fund Balance | <u>\$ 1,186</u> | <u>13,256</u> | <u>\$ 12,070</u> |
| Beginning fund balance | | 109,515 | |
| Ending Fund Balance | | <u>\$ 122,771</u> | |

Notes to Required Supplementary Information

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP)
- *2. Expenditures exceeded appropriations at the legal level of control.

City of Montgomery, Texas
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
CAPITAL PROJECTS FUND
For the Year Ended September 30, 2015

| | Original Budget | Amended and Final Budget | Actual | Variance with Final Budget Positive (Negative) |
|-----------------------------------|--------------------|-----------------------------|-------------------|---|
| <u>Revenues</u> | | | | |
| Intergovernmental | \$ - | \$ 1,000 | \$ - | \$ (1,000) |
| Interest | 1,000 | - | 105 | 105 |
| Total Revenues | 1,000 | 1,000 | 105 | (895) |
| <u>Expenditures</u> | | | | |
| Capital outlay | - | 257,324 | 41,073 | 216,251 |
| Total Expenditures | - | 257,324 | 41,073 | 216,251 |
| Net Change in Fund Balance | \$ 1,000 | \$ (256,324) | (40,968) | \$ (217,146) |
| Beginning fund balance | | | 258,030 | |
| Ending Fund Balance | | | \$ 217,062 | |

Notes to Required Supplementary Information

1. Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP).

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