

ANNUAL FINANCIAL REPORT

of the

City of Shepherd, Texas

**For the Year Ended
September 30, 2019**

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City of Shepherd, Texas

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September 30, 2019

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INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council
City of Shepherd, 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, and each major fund of the City of Shepherd, Texas (the "City"), as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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 from material misstatement.

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

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

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

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, and each major fund of the City as of September 30, 2019 and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note V.G. to the financial statements, the City restated beginning fund balance within the governmental activities and general fund for the correction of an accounting error in the prior year. 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 general fund budgetary comparison information, the schedule of changes in net pension liabilities and related ratios, the schedule of employer contributions to pension plan, and schedule of changes in the other postemployment benefits liability and related ratios, 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.

A handwritten signature in black ink that reads "Brooks Watson & Co." in a cursive, flowing script.

BrooksWatson & Co., PLLC
Certified Public Accountants
Houston, Texas
August 25, 2020

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

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City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

September 30, 2019

As management of the City of Shepherd, Texas (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended September 30, 2019. We encourage readers to consider the information presented here in conjunction with additional information contained in this report.

Financial Highlights

- The City's total combined net position was \$4,670,103 at September 30, 2019. Of this, \$1,270,693 (unrestricted net position) may be used to meet the City's ongoing obligations to its citizens and creditors.
- As of the end of the year, the unassigned fund balance of the general fund was \$499,073 or 88% of total general fund expenditures.
- The City had an overall decrease in net position of \$81,512.
- The City closed the year with a net pension asset of \$106,360.

Overview of the Financial Statements

The discussion and analysis provided here are intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements consist of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) the notes to financial statements. This report also includes supplementary information intended to furnish additional detail to support the basic financial statements themselves.

Government-Wide Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net position* presents information on all of the City's assets and liabilities. 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 fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2019

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, public works, and culture and recreation. The business-type activities of the City include sanitation operations.

FUND FINANCIAL STATEMENTS

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

Governmental Funds

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental 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 one individual 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 fund which is considered to be the only major fund.

The City adopts an annual appropriated budget for its general and water and sewer funds. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with the budget.

City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2019

Proprietary Funds

The City's proprietary funds are all enterprise funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses an enterprise fund to account for its water and sewer operations. All activities associated with providing such services are accounted for in these funds, including administration and water and sewer department operations. The City's intent is that costs of providing the services to the general public on a continuing basis is financed through user charges in a manner similar to a private enterprise.

Proprietary financial statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the sanitation fund, which is considered to be major fund of the City.

Component Unit

The City maintains the accounting and financial statements for one component unit. The Shepherd Economic Development Corporation is a discretely presented component unit displayed on the government-wide financial statements.

Notes to Financial Statements

The notes provide additional information that is necessary to acquire a full understanding of the data provided in the government-wide and fund 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 required RSI includes a budgetary comparison schedule for the general fund, schedule of changes in the net pension liability and related ratios and schedule of employer contributions for the 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 of Shepherd, assets exceeded liabilities by \$4,670,103 as of September 30, 2019, in the primary government.

The largest portion of the City's net position, \$3,011,138, reflects its investments in capital assets (e.g., land, city hall, community center, streets, and water and sewer systems, as well as the public works facilities), less any debt used to acquire those assets that are still outstanding. The City uses these

City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2019

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.

The following table reflects the condensed Statement of Net Position:

	2019			2018		
	Governmental	Business-Type		Governmental	Business-Type	
	Activities	Activities	Total	Activities	Activities	Total
Current and other assets	\$ 710,942	\$ 1,053,094	\$ 1,764,036	\$ 723,828	\$ 1,057,353	\$ 1,781,181
Long-term assets	1,956,072	2,424,827	4,380,899	1,996,434	2,554,004	4,550,438
Total Assets	2,667,014	3,477,921	6,144,935	2,720,262	3,611,357	6,331,619
Deferred Outflows of	17,997	29,284	47,281	5,325	8,664	13,989
Other liabilities	82,298	217,277	299,575	50,393	230,280	280,673
Long-term liabilities	7,520	1,188,043	1,195,563	6,941	1,274,386	1,281,327
Total Liabilities	89,818	1,405,320	1,495,138	57,334	1,504,666	1,562,000
Deferred Inflows of Resources	10,268	16,707	26,975	12,178	19,815	31,993
Net Position:						
Net investment in capital assets	1,915,586	1,095,552	3,011,138	1,938,800	1,111,897	3,050,697
Restricted	125,073	263,199	388,272	127,107	263,980	391,087
Unrestricted	544,266	726,427	1,270,693	590,168	719,663	1,309,831
Total Net Position	\$ 2,584,925	\$ 2,085,178	\$ 4,670,103	\$ 2,656,075	\$ 2,095,540	\$ 4,751,615

Long-term assets decreased by \$169,539 primarily due to annual depreciation on capital assets exceeding new asset purchases. Total liabilities decreased by \$66,862 due to the City's current year principal payments.

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2019

Statement of Activities:

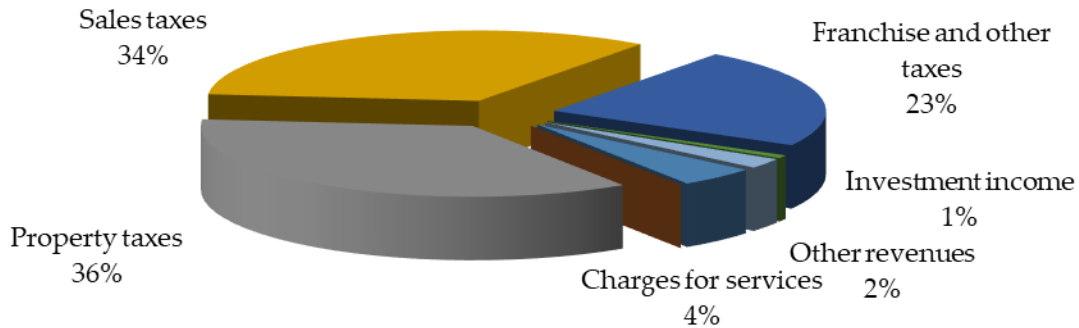
The following table provides a summary of the City's changes in net position:

	For the Year Ended September 30, 2019			For the Year Ended September 30, 2018		
			Total			Total
	Governmental	Business-Type	Primary	Governmental	Business-Type	Primary
	Activities	Activities	Government	Activities	Activities	Government
Revenues						
Program revenues:						
Charges for services	\$ 24,111	\$ 827,466	\$ 851,577	\$ 18,854	\$ 875,514	\$ 894,368
General revenues:						
Property taxes	186,991	-	186,991	171,305	-	171,305
Sales taxes	175,936	-	175,936	163,203	-	163,203
Franchise and other taxes	119,877	-	119,877	94,069	-	94,069
Investment income	3,682	2,820	6,502	2,171	1,803	3,974
Other revenues	12,126	-	12,126	5,437	-	5,437
Total Revenues	522,723	830,286	1,353,009	455,039	877,317	1,332,356
Expenses						
General government	254,556	-	254,556	248,731	-	248,731
Public safety	65,748	-	65,748	72,067	-	72,067
Highways and streets	101,001	-	101,001	91,836	-	91,836
Culture and recreation	172,568	-	172,568	199,668	-	199,668
Interest and fiscal charges	-	23,197	23,197	689	23,750	24,439
Water and sewer	-	817,451	817,451	-	767,044	767,044
Total Expenses	593,873	840,648	1,434,521	612,991	790,794	1,403,785
Change in Net Position	(71,150)	(10,362)	(81,512)	(157,952)	86,523	(71,429)
Beginning Net Position	2,656,075	2,095,540	4,751,615	2,814,027	2,009,017	4,823,044
Ending Net Position	\$ 2,584,925	\$ 2,085,178	\$ 4,670,103	\$ 2,656,075	\$ 2,095,540	\$ 4,751,615

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2019

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

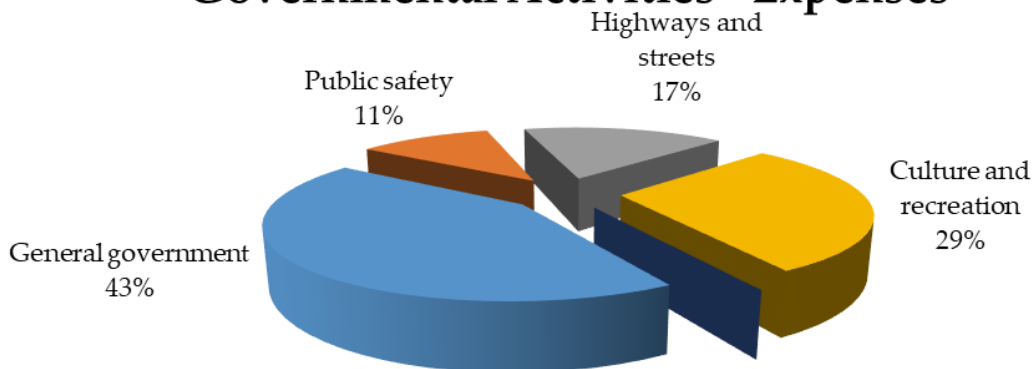
Governmental Activities - Revenues



For the year ended September 30, 2019, revenues from governmental activities totaled \$522,723. Property tax and sales tax are the City's largest revenue sources. Property taxes increased by \$15,686 or 9% due to an increase in the property appraisal values. Sales taxes increased by \$12,733 or 8% primarily as a result of continued economic growth in the City. Franchise and other taxes increased by \$25,808 or 27% primarily as a result of a missed payment by the hotel within the City in the 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, 2019, expenses for governmental activities totaled \$593,873. This represents a decrease of \$19,118 or 3% from the prior year. The City's largest functional expense is general governmental of \$254,556, which increased slightly by \$5,825 or 2%, which is considered minimal. Highways and streets decreased by \$9,165 or 10% primarily due to increases in street maintenance and depreciation expenses. Culture and recreation expenses decreased by \$27,100 or 14% primarily as a result of nonrecurring book expenses incurred in the prior year. All other expenditures remained relatively consistent with the previous year.

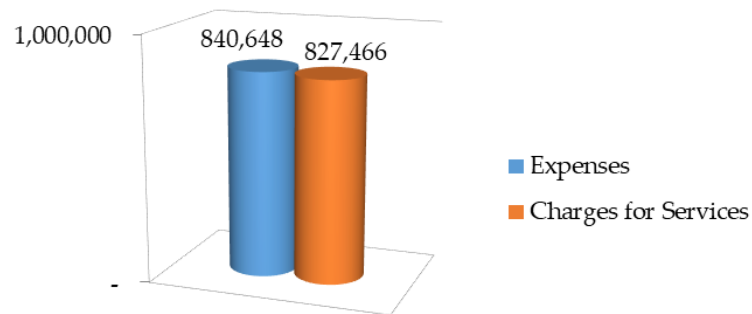
City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2019

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, 2019, charges for services by business-type activities totaled \$827,466. This is a decrease of \$48,048 or 5% over the prior year. The decrease is a result of a reduction in water and sewer consumption compared to the prior year.

Total expenses posted an increase of \$49,854 compared to the prior year. This increase is primarily a result of increased water tank and well maintenance, sewer plant maintenance and increased personnel expenses in the sewer department.

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.

As of the end of the year the general fund reflected a total fund balance of \$575,878. Unassigned fund balance totaled \$499,073 as of yearend. The general fund balance decreased by \$61,241 due to a budgeted use of fund balance.

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

City of Shepherd, Texas

MANAGEMENT'S DISCUSSION AND ANALYSIS, *Continued*

September 30, 2019

GENERAL FUND BUDGETARY HIGHLIGHTS

There was a total positive revenue variance of \$101,207 and a positive expenditure variance of \$4,598 for the year. This positive revenue variance was primarily the result of greater property, sales and franchise taxes received than anticipated. No supplemental budget amendments were made during the year.

CAPITAL ASSETS

As of the end of the year, the City's governmental activities funds had invested \$1,915,586 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 \$2,358,953 in a variety of capital assets and infrastructure, net of accumulated depreciation.

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

- Investment in city hall renovations totaling \$17,670.
- New fence was installed for \$15,256.
- Street improvements amounting to \$23,477.
- Purchase of new sewer system equipment totaling \$91,450.

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

LONG-TERM DEBT

At the end of the current year, the City had total bonds, premiums, notes, and leases outstanding of \$1,263,401. During the year, the City made payments on the long-term debt of \$84,934. More detailed information about the City's long-term liabilities is presented in note IV. E to the financial statements.

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 Shepherd and improving services provided to their public citizens. The City is budgeting for a reduction in sales tax revenue as a result of the COVID-19 pandemic.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the City of Shepherd'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's Finance Department.

FINANCIAL STATEMENTS

City of Shepherd, Texas
STATEMENT OF NET POSITION (Page 1 of 2)
September 30, 2019

	Primary Government			Component Unit
	Governmental	Business-Type		Shepherd
	Activities	Activities	Total	EDC
<u>Assets</u>				
Current assets:				
Cash and cash equivalents	\$ 142,012	\$ 293,199	\$ 435,211	\$ 271,203
Restricted cash	76,805	184,663	261,468	-
Investments	377,203	459,028	836,231	235,674
Receivables, net	114,922	116,204	231,126	82
Due from primary government	-	-	-	47,443
Total Current Assets	710,942	1,053,094	1,764,036	554,402
Capital assets:				
Non-depreciable	295,390	11,710	307,100	69,317
Net depreciable capital assets	1,620,196	2,347,243	3,967,439	343,098
Net pension asset	40,486	65,874	106,360	-
Total Noncurrent Assets	1,956,072	2,424,827	4,380,899	412,415
Total Assets	2,667,014	3,477,921	6,144,935	966,817
<u>Deferred Outflows of Resources</u>				
Pension contributions	2,665	4,336	7,001	-
Difference in pension assumptions	1,639	2,668	4,307	-
Pension investment returns	13,679	22,256	35,935	-
OPEB investment experience	14	24	38	-
Total Deferred Outflows of	17,997	29,284	47,281	-

See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF NET POSITION (Page 2 of 2)

September 30, 2019

	Primary Government			Component Unit
	Governmental	Business-Type	Total	Shepherd
	Activities	Activities		EDC
<u>Liabilities</u>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 27,475	\$ 8,130	\$ 35,605	\$ -
Customer deposits	-	108,757	108,757	-
Accrued interest payable	-	10,739	10,739	-
Due to component unit	47,443	-	47,443	-
Compensated absences, current	7,380	3,054	10,434	-
Long-term debt due within a one year	-	86,597	86,597	-
	<u>82,298</u>	<u>217,277</u>	<u>299,575</u>	<u>-</u>
Noncurrent liabilities:				
OPEB liability	6,700	10,900	17,600	-
Compensated absences, noncurrent	820	339	1,159	-
Long-term debt due in more than one year	-	1,176,804	1,176,804	-
	<u>7,520</u>	<u>1,188,043</u>	<u>1,195,563</u>	<u>-</u>
Total Liabilities	<u>89,818</u>	<u>1,405,320</u>	<u>1,495,138</u>	<u>-</u>
<u>Deferred Inflows of Resources</u>				
OPEB difference in expected and actual experience	67	109	176	-
Difference in expected and actual experience	10,201	16,598	26,799	-
Total Deferred Inflows of Resources	<u>10,268</u>	<u>16,707</u>	<u>26,975</u>	<u>-</u>
<u>Net Position</u>				
Net investment in capital assets	1,915,586	1,095,552	3,011,138	412,415
Restricted for:				
Grants	76,805	-	76,805	-
Pensions	48,268	78,536	126,804	-
Debt service	-	184,663	184,663	-
Economic development	-	-	-	554,402
Unrestricted	544,266	726,427	1,270,693	-
Total Net Position	<u>\$ 2,584,925</u>	<u>\$ 2,085,178</u>	<u>\$ 4,670,103</u>	<u>\$ 966,817</u>

See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF ACTIVITIES

For the Year Ended September 30, 2019

Functions/Programs	Expenses	Program Revenues
		Charges for Services
Primary Government		
Governmental Activities		
General government	\$ 254,556	\$ 14,341
Public safety	65,748	1,402
Highways and streets	101,001	8,368
Culture and recreation	172,568	-
Total Governmental Activities	593,873	24,111
Business-Type Activities		
Water and sewer	840,648	827,466
Total Business-Type Activities	840,648	827,466
Total Primary Government	\$ 1,434,521	\$ 851,577
Component Unit		
Shepherd EDC	40,014	-
Total Component Unit	\$ 40,014	-

General Revenues:

Taxes

Property taxes

Sales taxes

Franchise and other taxes

Investment income

Other revenues

Total General Revenues

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 Activities	Business-Type Activities	Total	Shepherd EDC
\$ (240,215)	\$ -	\$ (240,215)	\$ -
(64,346)	-	(64,346)	-
(92,633)	-	(92,633)	-
(172,568)	-	(172,568)	-
<u>(569,762)</u>	<u>-</u>	<u>(569,762)</u>	<u>-</u>
-	(13,182)	(13,182)	-
-	(13,182)	(13,182)	-
<u>(569,762)</u>	<u>(13,182)</u>	<u>(582,944)</u>	<u>-</u>
			(40,014)
			<u>\$ (40,014)</u>
186,991	-	186,991	-
175,936	-	175,936	87,968
119,877	-	119,877	-
3,682	2,820	6,502	2,860
12,126	-	12,126	25,500
<u>498,612</u>	<u>2,820</u>	<u>501,432</u>	<u>116,328</u>
(71,150)	(10,362)	(81,512)	76,314
2,656,075	2,095,540	4,751,615	890,503
<u>\$ 2,584,925</u>	<u>\$ 2,085,178</u>	<u>\$ 4,670,103</u>	<u>\$ 966,817</u>

City of Shepherd, Texas

BALANCE SHEET *GOVERNMENTAL FUND* September 30, 2019

	<u>General</u>
<u>Assets</u>	
Cash and cash equivalents	\$ 142,012
Restricted cash	76,805
Investments	377,203
Receivables, net	114,922
Total Assets	<u><u>\$ 710,942</u></u>
<u>Liabilities</u>	
Accounts payable and accrued liabilities	\$ 27,475
Due to component unit	47,443
Total Liabilities	<u><u>74,918</u></u>
<u>Deferred Inflows of Resources</u>	
Unavailable revenue: Property tax	60,146
Total Deferred Inflows of Resources	<u><u>60,146</u></u>
<u>Fund Balances</u>	
Restricted for: Grants	76,805
Unassigned reported in: General fund	499,073
Total Fund Balances	<u><u>575,878</u></u>
Total Liabilities and Fund Balances	<u><u>\$ 650,796</u></u>

See Notes to Financial Statements.

City of Shepherd, Texas

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

September 30, 2019

Fund Balances - Total Governmental Funds	\$	575,878
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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	295,390
Capital assets - net depreciable	1,620,196

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

Property tax receivable	60,146
Net pension asset	40,486

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 (expenditure) until then.

Pension contributions	2,665
Difference in pension assumptions	1,639
OPEB investment experience	14
Pension investment returns	13,679

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.

Difference in expected and actual experience	(10,201)
OPEB difference in expected and actual experience	(67)

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

Compensated absences	(8,200)
OPEB liability	(6,700)

Net Position of Governmental Activities	\$	2,584,925
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See Notes to Financial Statements.

City of Shepherd, Texas

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

For the Year Ended September 30, 2019

	<u>General</u>
<u>Revenues</u>	
Property tax	\$ 169,275
Sales tax	175,936
Franchise and other taxes	107,877
Charges for services	14,341
License and permits	8,368
Fines and forfeitures	1,402
Investment income	3,682
Contributions and donations	3,651
Other revenue	20,475
Total Revenues	<u>505,007</u>
<u>Expenditures</u>	
Current:	
General government:	255,322
Municipal court	59,898
Highway and streets	44,963
Culture and recreation	171,986
Capital outlay	34,079
Total Expenditures	<u>566,248</u>
Net Change in Fund Balances	<u>(61,241)</u>
Beginning fund balances	637,119
Ending Fund Balances	<u><u>\$ 575,878</u></u>

See Notes to Financial Statements.

City of Shepherd, Texas

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

For the Year Ended September 30, 2019

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

Net changes in fund balances - total governmental funds	\$	(61,241)
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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	62,163
Depreciation expense	(85,378)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	17,716
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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	(1,407)
Pension expense	(2,034)
OPEB expense	(969)

Change in Net Position of Governmental Activities	\$	(71,150)
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See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF NET POSITION PROPRIETARY FUND

September 30, 2019

	<u>Water and Sewer Fund</u>
<u>Assets</u>	
<u>Current Assets</u>	
Cash and cash equivalents	\$ 293,199
Restricted cash	184,663
Investments	459,028
Receivables, net	116,204
Total Current Assets	<u>1,053,094</u>
<u>Noncurrent Assets</u>	
Capital assets:	
Non-depreciable	11,710
Net depreciable capital assets	2,347,243
Net pension asset	65,874
Total Noncurrent Assets	<u>2,424,827</u>
Total Assets	<u>3,477,921</u>
<u>Deferred Outflows of Resources</u>	
Pension contributions	4,336
Pension investment returns	22,256
Difference in pension assumptions	2,668
OPEB investment experience	24
Total Deferred Outflows of Resources	<u>29,284</u>
<u>Liabilities</u>	
<u>Current Liabilities</u>	
Accounts payable and accrued liabilities	8,130
Customer deposits	108,757
Accrued interest	10,739
Compensated absences, current	3,054
Long-term debt due within a year	86,597
Total Current Liabilities	<u>217,277</u>
<u>Noncurrent Liabilities</u>	
OPEB liability	10,900
Compensated absences, noncurrent	339
Long-term debt due in more than one year	1,176,804
Total Noncurrent Liabilities	<u>1,188,043</u>
Total Liabilities	<u>1,405,320</u>
<u>Deferred Inflows of Resources</u>	
OPEB (gains) losses	109
Difference in expected and actual experience	16,598
Total Deferred Inflows of Resources	<u>16,707</u>
<u>Net Position</u>	
Net investment in capital assets	1,095,552
Restricted for pensions	78,536
Restricted for debt service	184,663
Unrestricted	726,427
Total Net Position	<u><u>\$ 2,085,178</u></u>

See Notes to Financial Statements.

City of Shepherd, Texas

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

For the Year Ended September 30, 2019

	<u>Water and Sewer Fund</u>
<u>Operating Revenues</u>	
Water sales	\$ 549,885
Sewer sales	273,473
Other revenue	4,108
Total Operating Revenues	<u>827,466</u>
<u>Operating Expenses</u>	
Administration	124,413
Water department	255,625
Sewer department	211,809
Depreciation	225,604
Total Operating Expenses	<u>817,451</u>
Operating Income (Loss)	<u>10,015</u>
<u>Nonoperating Revenues (Expenses)</u>	
Investment income	2,820
Interest expense	(23,197)
Total Nonoperating Revenues (Expenses)	<u>(20,377)</u>
Change in Net Position	<u>(10,362)</u>
Beginning net position	2,095,540
Ending Net Position	<u><u>\$ 2,085,178</u></u>

See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF CASH FLOWS PROPRIETARY FUND (Page 1 of 2) For the Year Ended September 30, 2019

	<u>Water and Sewer Fund</u>
<u>Cash Flows from Operating Activities</u>	
Receipts from customers	\$ 822,261
Payments to suppliers	(292,131)
Payments to employees	(312,754)
Net Cash Provided by Operating Activities	<u>217,376</u>
<u>Cash Flows from Capital and Related Financing Activities</u>	
Capital purchases	(124,325)
Principal paid on debt	(84,934)
Interest paid on debt	(23,197)
Net Cash (Used) by Capital and Related Financing Activities	<u>(232,456)</u>
<u>Cash Flows from Investing Activities</u>	
Purchase of investments	(1,905)
Interest on investments	2,820
Net Cash Provided by Investing Activities	<u>915</u>
Increase (Decrease) in Cash and Cash Equivalents	(14,165)
Beginning cash and cash equivalents	492,027
Ending Cash and Cash Equivalents	<u><u>\$ 477,862</u></u>

See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF CASH FLOWS

PROPRIETARY FUND (Page 2 of 2)

For the Year Ended September 30, 2019

	<u>Water and Sewer Fund</u>
<u>Reconciliation of Operating Income (Loss)</u>	
<u>to Net Cash Provided by Operating Activities</u>	
Operating Income (Loss)	\$ 10,015
Adjustments to reconcile operating income (loss) to net cash provided:	
Depreciation	225,604
Changes in Operating Assets and Liabilities:	
(Increase) Decrease in:	
Accounts receivable	(8,001)
Deferred Outflows of Resources:	
Pension contributions	(393)
Difference in pension assumptions	1,276
Pension investment returns	(33,319)
OPEB investment experience	(24)
Increase (Decrease) in:	
Accounts payable and accrued liabilities	(11,322)
Customer deposits	2,796
Compensated absences	(6,599)
Net pension liability	27,898
OPEB liability	713
Deferred Inflows of Resources:	
OPEB actuarial (gains) losses	886
Pension difference in expected and actual experience	7,846
Net Cash Provided by Operating Activities	\$ 217,376

See Notes to Financial Statements.

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City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS
September 30, 2019

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Government-Wide Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. *Governmental activities*, which normally are supported by taxes, intergovernmental revenues, and other nonexchange transactions, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges to external customers for support. Likewise, the *primary government* is reported separately from certain legally separate *component units* for which the primary government is financially accountable.

B. Reporting Entity

The City of Shepherd, Texas (the “City”) is a municipal corporation governed by an elected mayor and five-member governing council (“Council”). The accompanying financial statements present the City and its component unit, an entity for which the City is considered to be financially accountable.

The City is an independent political subdivision of the State of Texas governed by an elected council and is considered a primary government for financial reporting purposes as 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.

For financial reporting purposes, management has considered all potential component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GAAP. The criteria used are as follows:

Financial Accountability – The primary government is deemed to be financially accountable if it appoints a voting majority of the organization's governing body and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits or impose specific financial burdens on the primary government. Additionally, the primary government may be financially accountable if an organization is fiscally dependent on the primary government and there is a potential for the organization to provide specific financial benefits or impose specific financial burdens on the primary government regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government or a jointly appointed board.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

Discretely Presented Component Unit

Shepherd Economic Development Corporation ("SEDC")

The SEDC is managed by a board of directors appointed by City Council. The Board is composed of nine members, seven of which are voting members and two of which are "advisory directors" who cannot vote on any actions of the SEDC. No more than four members of the Board may be a member of City Council or any other officer or employee of the City. The nine members of the Board must all be residents of San Jacinto County and are grouped as follows: six "citizen class" directors, one "city class" director, and the two "advisory class" directors. The SEDC was created to promote community improvement and economic development within the City and the State of Texas and the public welfare of, for, and on behalf of the City by developing, implementing, providing, and financing projects.

C. Basis of Presentation – Government-Wide and Fund Financial Statements

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

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments in lieu of taxes where the amounts are reasonably equivalent in value to the interfund services provided and other charges between the government's sanitation and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

The fund financial statements provide information about the government's funds, including its blended component units. Separate statements for each fund category—governmental and proprietary are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds. Major individual governmental and enterprise funds are reported as separate columns in the fund financial statements.

The government reports the following major governmental funds:

General Fund

The general fund is the main operating fund of the City and is used to account for all financial resources of the general government, except those accounted for in another fund. The principal sources of revenues include local property taxes, sales and franchise taxes, and

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

charges for services. Expenditures include general government, municipal court, highway and streets, and culture and recreation.

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 government reports the following major enterprise fund:

Water and Sewer Fund

This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the costs (expenses, including depreciation) of providing water and sewer services to the general public on a continuing basis are financed or recovered primarily through user charges or periodic determination of revenues earned, expenses incurred and/or net income is appropriated for capital maintenance, public policy, management control, accountability, or other purposes.

During the course of operations, the government has activity between funds for various purposes. Any residual balances outstanding at year end are reported as due from/to other funds and advances to/from other funds. While these balances are reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Balances between the funds included in governmental activities (i.e., the governmental and internal service funds) are eliminated so that only the net amount is included as internal balances in the governmental activities column. Similarly, balances between the funds included in business-type activities (i.e., the enterprise funds) are eliminated so that only the net amount is included as internal balances in the business-type activities column.

Further, certain activity occurs during the year involving transfers of resources between funds. In fund financial statements these amounts are reported at gross amounts as transfers in/out. While reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Transfers between the funds included in governmental activities are eliminated so that only the net amount is included as transfers in the governmental activities column. Similarly, balances between the funds included in business-type activities are

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

eliminated so that only the net amount is included as transfers in the business-type activities column.

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.

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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. Fair Value

The City has applied Governmental Accounting Standards Board ("GASB") Statement No. 72, Fair Value Measurement and Application. GASB Statement No. 72 provides guidance for determining a fair value measurement for reporting purposes and applying fair value to certain investments and disclosures related to all fair value measurements.

3. 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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

between the primary government and its component unit, these receivables and payables are classified as “due to/from 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.

4. 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.

5. Inventories and Prepaid Items

The costs of governmental fund type inventories are recorded as expenditures when the related liability is incurred, (i.e., the purchase method). The inventories are valued at the lower of cost or market using the first-in/first-out method. Certain payments to vendors reflect costs applicable to future accounting periods (prepaid expenditures) are recognized as expenditures when utilized.

6. 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 \$2,500 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.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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.

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
Water system	10 - 40 years
Sewer system	5 - 40 years
Buildings and improvements	7 - 50 years
Furniture and equipment	3 - 15 years
Machinery, equipment, and vehicles	3 - 15 years
Infrastructure	7 - 30 years

7. 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 financial position will sometimes report a separate section for *deferred inflows of resources*. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The 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. The governmental funds report unavailable revenues from property taxes and fines and forfeitures. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available. Deferred inflows of resources can also occur at the government wide level due to differences between investment gains and losses realized on pension investments compared to assumption used within the pension actuarial valuation model.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

8. 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.

9. 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.

10. 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 City 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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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.

11. Compensated Absences

It is the City's policy to permit employees to accumulate earned by unused sick pay benefits. There is no liability for unpaid accumulated sick leave since the City does not have a policy to pay any amounts when employees separate from service with the City.

It is the City's policy to provide vacation benefits to employees after one year of service. Vacation accrues in one to four-week increments depending on the employees' length of service. Benefits per employee cannot accumulate in excess of the employee's accrual for one year. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in the governmental funds when the individual is eligible for the benefit.

12. 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, capital leases, 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 similar items 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.

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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

13. Pensions

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the Fiduciary Net Position of the Texas Municipal Retirement System (TMRS) and additions to/deductions from TMRS's Fiduciary Net Position have been determined on the same basis as they are reported by TMRS. For this purpose, plan contributions are recognized in the period that compensation is reported for the employee, which is when contributions are legally due. Benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

14. Other Postemployment Benefits ("OPEB")

The City has implemented GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. This statement applies to the individual employers (TMRS cities) in the TMRS Supplemental Death Benefits (SDB) plan, with retiree coverage. The TMRS SDBF covers both active and retiree benefits with no segregation of assets, and therefore doesn't meet the definition of a trust under GASB No. 75 (i.e., no assets are accumulated for OPEB) and as such the SDBF is considered to be an unfunded OPEB plan. For purposes of reporting under GASB 75, the retiree portion of the SDBF is not considered a cost sharing plan and is instead considered a single employer, defined benefit OPEB plan. The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary, calculated based on the employee's actual earnings on which TMRS deposits are made, for the 12-month period preceding the month of death. The death benefit amount for retirees is \$7,500. GASB No. 75 requires the liability of employers and nonemployer contributing entities to employees for defined benefit OPEB (net OPEB liability) to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service (total OPEB liability), less the amount of the OPEB plan's fiduciary net position.

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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 sanitation fund are charges to customers for sales and services. 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. Reconciling items have been presented on the balance sheet of governmental funds in the basic financial statements.

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 premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities.” A reconciliation has been presented in the basic financial statements.

III. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles (GAAP) for the general fund. 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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

level. No funds can be transferred or added to a budgeted fund without Council approval. Appropriations lapse at the end of the year.

A. Expenditures Over Appropriations

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

General Fund:

General government	\$ 28,226
Culture and recreation	\$ 1,536
Capital outlay	\$ 14,079

IV. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

As of September 30, 2019, the primary government had the following investments:

<u>Investment Type</u>	<u>Carrying Value</u>	<u>Average Maturity (Years)</u>
Certificates of deposit	\$ 836,231	0.26
Total carrying value	<u>\$ 836,231</u>	
Portfolio weighted average maturity		0.26

As of September 30, 2019, the discretely presented component unit had the following investments:

<u>Investment Type</u>	<u>Carrying Value</u>	<u>Average Maturity (Years)</u>
Certificates of deposit	\$ 235,674	0.58
Total carrying value	<u>\$ 235,674</u>	
Portfolio weighted average maturity		0.58

Interest rate risk In accordance with its investment policy, the City manages its exposure to declines in fair values by investing funds in interest-bearing deposit accounts at the bank depository and 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 certificates of deposits.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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Credit risk Credit risk is the risk that an issuer or other counterpart to an investment will not fulfill its obligations. For the year ending September 30, 2019, the City is not exposed to credit risk as all cash equivalents are certificates of deposit with bank depository, which are fully insured and collateralized.

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 value of not less than the principal amount of the deposits. As of September 30, 2019, 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 is not exposed to custodial risk due to the cash equivalents, certificates of deposit at bank depository, are insured or registered in the City's name or the investments are held by the City or its agents.

B. Fair Value Measurement

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Investments that are remeasured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy noted above.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The City's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The City's financial instruments consist of cash and cash equivalents, investments in certificates of deposits maturing in greater than three months, accounts receivable and accrued payables. The estimated fair value approximate their carrying amounts due to the short-term nature of these instruments.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

C. Receivables

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

	General	Water and Sewer	Total
Property taxes	\$ 60,146	\$ -	\$ 60,146
Sales tax	51,091	-	51,091
Franchise and other taxes	3,685	-	3,685
Accounts	-	124,587	124,587
Allowance	-	(8,383)	(8,383)
	<u>\$ 114,922</u>	<u>\$ 116,204</u>	<u>\$ 231,126</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

D. Capital Assets

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

	Beginning Balances	Increases	Decreases/ Reclassifications	Ending Balances
Capital assets, not being depreciated:				
Land and improvements	\$ 295,390	\$ -	\$ -	\$ 295,390
Total capital assets not being depreciated	<u>295,390</u>	<u>-</u>	<u>-</u>	<u>295,390</u>
Capital assets, being depreciated:				
Buildings and improvements	1,070,268	17,670	-	1,087,938
Furniture and equipment	64,866	-	-	64,866
Vehicles, machinery & equipment	181,346	-	-	181,346
Infrastructure	1,041,496	44,493	-	1,085,989
Total capital assets being depreciated	<u>2,357,976</u>	<u>62,163</u>	<u>-</u>	<u>2,420,139</u>
Less accumulated depreciation				
Buildings and improvements	(257,259)	(21,144)	-	(278,403)
Furniture and equipment	(55,142)	(2,346)	-	(57,488)
Vehicles, machinery & equipment	(130,496)	(8,667)	-	(139,163)
Infrastructure	(271,668)	(53,221)	-	(324,889)
Total accumulated depreciation	<u>(714,565)</u>	<u>(85,378)</u>	<u>-</u>	<u>(799,943)</u>
Net capital assets being depreciated	<u>1,643,411</u>	<u>(23,215)</u>	<u>-</u>	<u>1,620,196</u>
Total Net Capital Assets	<u><u>\$ 1,938,801</u></u>	<u><u>\$ (23,215)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 1,915,586</u></u>

Depreciation was charged to governmental functions as follows:

General government	\$ 22,908
Public safety	5,850
Highways and streets	56,038
Culture and recreation	582
Total Governmental Activities Depreciation Expense	<u><u>\$ 85,378</u></u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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

	Beginning Balances	Increases	Decreases/ Reclassifications	Ending Balances
Capital assets, not being depreciated:				
Land and improvements	\$ 11,710	\$ -	\$ -	\$ 11,710
Total capital assets not being depreciated	<u>11,710</u>	<u>-</u>	<u>-</u>	<u>11,710</u>
Capital assets, being depreciated:				
Water system	2,444,796	21,398	-	2,466,194
Sewer system	4,173,137	91,450	-	4,264,587
Buildings and improvements	28,501	-	-	28,501
Vehicles, machinery and equipment	466,502	11,477	-	477,979
Total capital assets being depreciated	<u>7,112,936</u>	<u>124,325</u>	<u>-</u>	<u>7,237,261</u>
Less accumulated depreciation				
Water system	(1,805,349)	(41,413)	-	(1,846,762)
Sewer system	(2,634,094)	(144,125)	-	(2,778,219)
Buildings and improvements	(28,501)	-	-	(28,501)
Vehicles, machinery and equipment	(196,470)	(40,066)	-	(236,536)
Total accumulated depreciation	<u>(4,664,414)</u>	<u>(225,604)</u>	<u>-</u>	<u>(4,890,018)</u>
Net capital assets being depreciated	<u>2,448,522</u>	<u>(101,279)</u>	<u>-</u>	<u>2,347,243</u>
Total Net Capital Assets	<u><u>\$ 2,460,232</u></u>	<u><u>\$ (101,279)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 2,358,953</u></u>

Depreciation was charged to business-type functions as follows:

Water	\$ 81,479
Sewer	<u>144,125</u>
Total Business-type Activities Depreciation Expense	<u><u>\$ 225,604</u></u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

A summary of changes in component unit activities capital assets for the year was as follows:

	Beginning Balances	Increases	Decreases/ Reclassifications	Ending Balances
Capital assets, not being depreciated:				
Land and improvements	\$ 69,317	\$ -	\$ -	\$ 69,317
Total capital assets not being depreciated	<u>69,317</u>	<u>-</u>	<u>-</u>	<u>69,317</u>
Capital assets, being depreciated:				
Buildings and improvements	391,645	-	-	391,645
Total capital assets being depreciated	<u>391,645</u>	<u>-</u>	<u>-</u>	<u>391,645</u>
Less accumulated depreciation				
Buildings and improvements	(40,476)	(8,071)	-	(48,547)
Total accumulated depreciation	<u>(40,476)</u>	<u>(8,071)</u>	<u>-</u>	<u>(48,547)</u>
Net capital assets being depreciated	351,169	(8,071)	-	343,098
Total Net Capital Assets	<u>\$ 420,486</u>	<u>\$ (8,071)</u>	<u>\$ -</u>	<u>\$ 412,415</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

E. Long-term Debt

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

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
Business-Type Activities:					
Bonds and other payables:					
Certificates of obligation	\$ 519,000	\$ -	\$ (17,000)	\$ 502,000	\$ 17,000
Capital lease payable	132,793	-	(30,934)	101,859	32,397
Note payable	696,542	-	(37,000)	659,542	37,200
Total Business-Type Activities	<u>\$ 1,348,335</u>	<u>\$ -</u>	<u>\$ (84,934)</u>	<u>\$ 1,263,401</u>	<u>\$ 86,597</u>
Long-term liabilities due in more than one year				<u>\$ 1,176,804</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.

Long-term debt at year end was comprised of the following debt issues as of September 30, 2019:

	Business - Type Activities	Total
Capital Lease Obligations:		
\$170,005 Lease agreement with Kubota, due in annual installments through 2022, interest at 4.73%	\$ 101,859	\$ 101,859
Total Capital Lease Obligations	<u>\$ 101,859</u>	<u>\$ 101,859</u>
Certificates of Obligation:		
\$720,000 Certificates of Obligation, Series 1999, due in annual installments through 2038, interest at 3.25%	\$ 502,000	\$ 502,000
Total Certificates of Obligation	<u>\$ 502,000</u>	<u>\$ 502,000</u>
Notes Payable:		
\$773,742 Note payable to TXDOT, due in annually installments of \$37,200 through 2037, interest at 0%	\$ 659,542	\$ 659,542
Total Notes Payable	<u>\$ 659,542</u>	<u>\$ 659,542</u>
Total Long-term Debt	<u>\$ 1,263,401</u>	<u>\$ 1,263,401</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

The annual requirements to amortize total business-type activities debt issues outstanding at year ending were as follows:

Year ending September 30,	Certificates of Obligation		Note Payable		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2020	\$ 17,000	\$ 16,426	\$ 37,200	\$ -	\$ 54,200	\$ 16,426
2021	18,000	15,870	37,200	-	55,200	15,870
2022	19,000	15,281	37,200	-	56,200	15,281
2023	20,000	14,659	37,200	-	57,200	14,659
2024	21,000	14,005	37,200	-	58,200	14,005
2025	22,000	13,317	37,200	-	59,200	13,317
2026	23,000	12,598	37,200	-	60,200	12,598
2027	24,000	11,845	37,200	-	61,200	11,845
2028	25,000	11,060	37,200	-	62,200	11,060
2029	26,000	10,242	37,200	-	63,200	10,242
2030	27,000	9,391	37,200	-	64,200	9,391
2031	28,000	8,507	37,200	-	65,200	8,507
2032	29,000	7,591	37,200	-	66,200	7,591
2033	31,000	6,642	37,200	-	68,200	6,642
2034	32,000	5,628	37,200	-	69,200	5,628
2035	33,000	4,581	37,200	-	70,200	4,581
2036	34,000	3,501	37,200	-	71,200	3,501
2037	36,000	2,389	27,142	-	63,142	2,389
2038	37,000	1,211	-	-	37,000	1,211
	<u>\$ 502,000</u>	<u>\$ 184,744</u>	<u>\$ 659,542</u>	<u>\$ -</u>	<u>\$ 1,161,542</u>	<u>\$ 184,744</u>

Year ending September 30,	Capital Lease		Total
	Principal	Interest	
2020	\$ 32,397	\$ 4,814	\$ 37,212
2021	33,928	3,283	37,211
2022	35,534	1,679	37,213
	<u>\$ 101,859</u>	<u>\$ 9,776</u>	<u>\$ 111,636</u>

The asset under capital lease had an original book value of \$170,005 and a net book value of \$125,480 as of September 30, 2019. Capital leases are secured by the underlying asset. In the event of default, the lender may demand immediate payment or take possession of the asset.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

F. Other Long-term Liabilities

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

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Governmental Activities:					
Compensated Absences	\$ 6,793	\$ 1,407	\$ -	\$ 8,200	\$ 7,380
Total Governmental Activities	<u>\$ 6,793</u>	<u>\$ 1,407</u>	<u>\$ -</u>	<u>\$ 8,200</u>	<u>\$ 7,380</u>
Other Long-term Liabilities Due in More than One Year				<u>\$ 820</u>	
Business-Type Activities:					
Compensated Absences	\$ 9,992	\$ -	\$ (6,599)	\$ 3,393	\$ 3,054
Total Business-Type Activities	<u>\$ 9,992</u>	<u>\$ -</u>	<u>\$ (6,599)</u>	<u>\$ 3,393</u>	<u>\$ 3,054</u>
Other Long-term Liabilities Due in More than One Year				<u>\$ 339</u>	

G. Customer Deposits

The City had customer deposits of \$108,757 in the water and sewer fund as of yearend. The City requires a \$100 deposit for all utility customers. All deposits are applied to the account balance or refunded when service is discontinued.

H. Restricted Assets – restricted cash

The restricted assets presented by the City as of yearend consist of cash and cash equivalents, and include restricted grant fund and bond reserves as follows:

	<u>General</u>	<u>Water and Sewer Fund</u>
Debt service - reserve funds	\$ -	\$ 184,663
Grant funds	76,805	-
Total restricted assets	<u>\$ 76,805</u>	<u>\$ 184,663</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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V. 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 more than 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 pays an annual premium to TML for its above insurance coverages. The agreement for the formulation of TML provides that TML will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of acceptable risk levels; however, each category of coverage has its own level of assurance. There were no significant reductions in insurance coverages in the past fiscal year and settled claims resulting from these risks have not exceeded coverage in any of the past three fiscal years.

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 general revenues of the City are contingently liable for the \$502,000 payable in Certificates of Obligation, which are currently outstanding and recorded as an obligation of the Water and Sewer Fund. The full faith and credit of the City is pledged to redeem these certificates if revenues from the Water and Sewer Fund are insufficient to meet the obligations.

C. Interlocal Agreements

The City entered into an interlocal agreement with San Jacinto County whereas the City will compensate the County in cash in consideration of the County paving and/or repairing the City's streets and roads authorized by the City.

The City entered into an interlocal agreement with Precinct Two Constable's Office of San Jacinto County whereas the City will compensate the Constable's Office in cash in consideration of law enforcement services performed in the City by a County Constable. The City agrees to provide

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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the Constable as compensation for services performed under this agreement a sum of \$70,000 per year as follows:

- \$43,000 will be paid in total annual compensation for the Constable to provide services and an additional \$27,000 will be available for the purchase of a City-owned patrol vehicle for the Constable, emergency equipment on the vehicle, and vehicle maintenance and fuel.

D. 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 not anticipate that it will have an arbitrage liability and reviews the estimate for this potential liability annually. The City has engaged an arbitrage consultant to perform the calculations in accordance with Internal Revenue Service's rules and regulations.

E. Defined Benefit Pension Plans

Texas Municipal Retirement System

1. Plan Description

The City of Shepherd, Texas participates as one of 887 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 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.tmrs.com.

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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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 2018</u>	<u>Plan Year 2017</u>
Employee deposit rate	7%	7%
Matching ratio (city to employee)	1.5 to 1	1.5 to 1
Years required for vesting	5	5
Service retirement eligibility (expressed as age / years of service)	60/5, 0/25	60/5, 0/25
Updated service credit	0%	0%
Annuity increase (to retirees)	0% of CPI	0% of CPI
Active Employees	Yes	Yes
Supplemental Death Benefit to Retirees	Yes	Yes

Employees covered by benefit terms

At the December 31, 2018 valuation and measurement date, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	2
Inactive employees entitled to but not yet receiving benefits	6
Active employees	<u>11</u>
Total	<u>19</u>

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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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 Shepherd, Texas were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution rates for the City of Shepherd, Texas were 2.41% and 2.70% in calendar years 2018 and 2019, respectively. The City's contributions to TMRS for the year ended September 30, 2019, were \$8,877, and were equal to the required contributions.

4. Net Pension Liability (Asset)

The City's Net Pension Liability (Asset) was measured as of December 31, 2018, and the Total Pension Liability (TPL) used to calculate the Net Pension Liability (Asset) was determined by an actuarial valuation as of that date.

Actuarial assumptions

The Total Pension Liability in the December 31, 2018 actuarial valuation was determined using the following actuarial assumptions:

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

Salary increases were based on a service-related table. Mortality rates for active members, retirees, and beneficiaries were based on the gender-distinct RP2000 Combined Healthy Mortality Tables with Blue Collar Adjustment, 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 Combined Healthy Mortality Tables with Blue Collar Adjustment are used with males rates multiplied by 109% and female rates multiplied by 103% with a 3-year set-forward for both males and females. In addition, a 3% minimum mortality rate is applied to reflect the impairment for younger members who become disabled. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements subject to the 3% floor.

The actuarial assumptions were developed primarily from the actuarial investigation of the experience of TMRS over the four year period from December 31, 2010 to December 31, 2014. They were adopted in 2015 and first used in the December 31, 2015 actuarial valuation. The post-retirement mortality assumption for healthy annuitants and Annuity Purchase Rate (APRs) are based on the Mortality Experience Investigation Study covering 2009 through 2011 and dated

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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December 31, 2013. In conjunction with these changes first used in the December 31, 2013 valuation, the System adopted the Entry Age Normal actuarial cost method and a one-time change to the amortization policy. 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. In determining their best estimate of a recommended investment return assumption under the various alternative asset allocation portfolios, GRS focused on the area between (1) arithmetic mean (aggressive) without an adjustment for time (conservative) and (2) the geometric mean (conservative) with an adjustment for time (aggressive). The target allocation and best estimates of real rates of return for each major asset class in fiscal year 2019 are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return (Arithmetic)
Domestic Equity	17.5%	4.30%
International Equity	17.5%	6.10%
Core Fixed Income	10.0%	1.00%
Non-Core Fixed Income	20.0%	3.39%
Real Return	10.0%	3.78%
Real Estate	10.0%	4.44%
Absolute Return	10.0%	3.56%
Private Equity	5.0%	7.75%
Total	100.0%	

Discount Rate

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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

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

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

1% Decrease 5.75%	Current Single Rate Assumption 6.75%	1% Increase 7.75%
\$ (37,433)	\$ (106,360)	\$ (164,307)

Changes in the Net Pension Liability (Asset)

	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension (Asset) Liability (a) – (b)
Balance at 12/31/17	\$ 538,544	\$ 689,949	\$ (151,405)
Changes for the year:			
Service cost	41,009	-	41,009
Interest	36,726	-	36,726
Difference between expected and actual experience	(21,524)	-	(21,524)
Contributions – employer	-	8,265	(8,265)
Contributions – employee	-	24,002	(24,002)
Net investment income	-	(20,680)	20,680
Change of assumptions	-	-	-
Benefit payments, including refunds of emp. contributions	(29,906)	(29,906)	-
Administrative expense	-	(399)	399
Other changes	-	(22)	22
Net changes	26,305	(18,740)	45,045
Balance at 12/31/18	\$ 564,849	\$ 671,209	\$ (106,360)

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.tmr.com.

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

For the year ended September 30, 2019, the city recognized pension expense of \$14,240.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

At September 30, 2019, 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 in pension assumptions	\$ 4,307	\$ -
Difference in expected vs. actual experience	-	(26,799)
Investment returns	35,935	-
Contributions subsequent to the measurement date	7,001	-
Total	\$ 47,243	\$ (26,799)

The City reported \$7,001 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, 2020. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:

2019	\$ 5,376
2020	(1,913)
2021	1,291
2022	9,558
2023	(869)
Thereafter	-
	\$ 13,443

Other Postemployment Benefits

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

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

The City contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure that adequate resources are available to meet all

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

death benefit payments for the upcoming year; the intent is not to pre-fund retiree term life insurance during employees' entire careers.

Employees covered by benefit terms

At the December 31, 2018 valuation and measurement date, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	1
Inactive employees entitled to but not yet receiving benefits	2
Active employees	11
Total	14

The City's retiree contributions to the TMRS SDBF for the fiscal years ended 2019, 2018 and 2017 were \$0, respectively, which equaled the required contributions each year.

Schedule of Contribution Rates
(RETIREE-only portion of the rate)

Plan/ Calendar Year	Annual Required Contribution (Rate)	Actual Contribution Made (Rate)	Percentage of ARC Contributed
2017	0.00%	0.00%	N/A
2018	0.00%	0.00%	N/A
2019	0.00%	0.00%	N/A

Total OPEB Liability

The City's Postemployment Benefits Other Than Pensions Liability (OPEB) was measured as of December 31, 2018, and the Total OPEB Liability was determined by an actuarial valuation as of that date.

Actuarial assumptions:

The Total OPEB Liability in the December 31, 2018 actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.5% per year
Overall payroll growth	3.5% to 10.5%, including inflation per year
Discount rate	3.71%
Retirees' share of benefit-related costs	\$0

City of Shepherd, Texas

NOTES TO FINANCIAL STATEMENTS, *Continued*

September 30, 2019

Administrative expenses

All administrative expenses are paid through the Pension Trust and accounted for under reporting requirements under GASB Statement No. 68

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

Discount Rate:

The discount rate used to measure the Total OPEB Liability was 3.71%. The discount rate was based on the Fidelity Index's "20-Year Municipal GO AA Index" rate as of December 31, 2018.

Sensitivity of the Total OPEB Liability to Changes in the Discount Rate

The following presents the total OPEB liability of the City, calculated using the discount rate of 3.71%, as well as what the City's total OPEB liability (asset) would be if it were calculated using a discount rate that is 1-percentage-point lower (2.71%) or 1-percentage-point higher (4.71%) than the current rate:

1% Decrease (2.71%)	Current Single Rate Assumption 3.71%	1% Increase (4.71%)
\$ 21,397	\$ 17,600	\$ 14,743

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

Changes in the Total OPEB Liability:

	Total OPEB Liability
Balance at 12/31/17	\$ 16,449
Changes for the year:	
Service Cost	1,954
Interest	577
Difference between expected and actual experience	45
Changes of assumptions	(1,425)
Benefit payments	-
Net changes	1,151
Balance at 12/31/18	\$ 17,600

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

For the year ended September 30, 2019, the City recognized OPEB expense of \$2,544.

At September 30, 2019, the City reported deferred outflows of resources and deferred inflows of resources related to the OPEB liability from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ 38	\$ -
Change in assumptions	-	(176)
Total	\$ 38	\$ (176)

The City reported \$0 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, 2020.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2019

Other amounts reported as deferred outflows of resources related to OPEB will be recognized in pension expense as follows:

Year ended December 31:		
2019	\$	13
2020		13
2021		13
2022		13
2023		(28)
Thereafter		(162)
	\$	<u>(138)</u>

F. Related Party Transactions

During the year, a City Council member rented an office from the City for \$500 per month. No other related party transactions occurred during the year ended September 30, 2019.

G. Restatement

The City restated beginning net position/fund balance within governmental activities and the general fund for the correction of an accounting error in the prior year.

The restatement of beginning net position/fund balance is as follows:

	Governmental Activities	General
Prior year ending net position/ fund balance, as reported	\$ 2,556,714	\$ 537,758
Correction in recording of restricted assets	99,361	99,361
Restated beginning net position/fund balance	<u>\$ 2,656,075</u>	<u>\$ 637,119</u>

H. Subsequent Events

There were no material subsequent events through August 25, 2020, the date the financial statements were issued.

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REQUIRED SUPPLEMENTARY INFORMATION

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City of Shepherd, Texas
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL
GENERAL FUND
For the Year Ended September 30, 2019

	Original & Final Budget	Actual	Variance with Final Budget Positive (Negative)
<u>Revenues</u>			
Property tax	\$ 154,000	\$ 169,275	\$ 15,275
Sales tax	150,000	175,936	25,936
Franchise and other taxes	75,000	107,877	32,877
Charges for services	9,300	14,341	5,041
License and permits	3,000	8,368	5,368
Fines and forfeitures	1,200	1,402	202
Investment income	1,300	3,682	2,382
Contributions and donations	-	3,651	3,651
Other revenue	10,000	20,475	10,475
Total Revenues	403,800	505,007	101,207
<u>Expenditures</u>			
Current:			
General government:	227,096	255,322	(28,226) *
Municipal court	98,800	59,898	38,902
Highway and streets	54,500	44,963	9,537
Culture and recreation	170,450	171,986	(1,536) *
Capital outlay	20,000	34,079	(14,079) *
Total Expenditures	570,846	566,248	4,598
Revenues Over (Under) Expenditures	(167,046)	(61,241)	105,805
Net Change in Fund Balance	\$ (167,046)	(61,241)	\$ 105,805
Beginning fund balance		637,119	
Ending Fund Balance		\$ 575,878	

Notes to Required Supplementary Information

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

* Expenditures exceeded appropriations at the legal level of control.

See Notes to Financial Statements.

City of Shepherd, Texas

SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS

December 31,

	2014	2015	2016
Total pension liability			
Service cost	\$ 30,359	\$ 31,757	\$ 35,252
Interest	24,514	27,998	28,859
Changes in benefit terms	-	-	-
Differences between expected and actual experience	1,318	(35,142)	2,299
Changes of assumptions	-	12,548	-
Benefit payments, including refunds of participant contributions	(245)	(13,982)	(8,713)
Net change in total pension liability	55,946	23,179	57,697
Total pension liability - beginning	335,139	391,085	414,264
Total pension liability - ending (a)	391,085	414,264	471,961
Plan fiduciary net position			
Contributions - employer	\$ 3,132	\$ 6,064	\$ 6,728
Contributions - members	17,850	18,871	20,327
Net investment income	27,050	768	35,924
Benefit payments, including refunds of participant contributions	(245)	(13,982)	(8,713)
Administrative expenses	(282)	(468)	(406)
Other	(23)	(23)	(22)
Net change in plan fiduciary net position	47,482	11,230	53,838
Plan fiduciary net position - beginning	472,850	520,332	531,562
Plan fiduciary net position - ending (b)	\$ 520,332	\$ 531,562	\$ 585,400
Fund's net pension liability (asset) - ending (a) - (b)	\$ (129,247)	\$ (117,298)	\$ (113,439)
Plan fiduciary net position as a percentage of the total pension liability	133%	128%	124%
Covered payroll	\$ 254,998	\$ 269,584	\$ 290,382
Fund's net position as a percentage of covered payroll	-51%	-44%	-39%

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.

See Notes to Financial Statements.

	2017	2018 ¹
	<hr/>	<hr/>
\$	38,703	\$ 41,009
	32,918	36,726
	-	-
	2,237	(21,524)
	-	-
	(7,275)	(29,906)
	<hr/>	<hr/>
	66,583	26,305
	<hr/>	<hr/>
	471,961	538,544
	<hr/>	<hr/>
	538,544	564,849
	<hr/>	<hr/>
\$	8,407	\$ 8,265
	22,709	24,002
	81,151	(20,680)
	(7,275)	(29,906)
	(420)	(399)
	(23)	(22)
	<hr/>	<hr/>
	104,549	(18,740)
	<hr/>	<hr/>
	585,400	689,949
	<hr/>	<hr/>
\$	689,949	\$ 671,209
	<hr/>	<hr/>
\$	<u>(151,405)</u>	<u>\$ (106,360)</u>
	<hr/>	<hr/>
	128%	119%
\$	324,417	342,889
	-47%	-31%

City of Shepherd, Texas

SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN

Years Ended:

	<u>9/30/2015</u>	<u>9/30/2016</u>	<u>9/30/2017</u>
Actuarially determined employer contributions	\$ 5,157	\$ 6,816	\$ 8,036
Contributions in relation to the actuarially determined contribution	\$ 5,157	\$ 6,816	\$ 8,036
Contribution deficiency (excess)	\$ -	\$ -	\$ -
Annual covered payroll	\$ 261,347	\$ 296,437	\$ 318,665
Employer contributions as a percentage of covered payroll	1.97%	2.30%	2.52%

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	2.5%
Salary Increases	3.50% to 10.5% including inflation
Investment Rate of Return	6.75%
Retirement Age	Experience-based table of rates that are specific to the City's plan of benefits. Last updated for the 2015 valuation pursuant to an experience study of the period 2010 - 2014
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.

See Notes to Financial Statements.

<u>9/30/2018</u>	<u>9/30/2019</u> ¹
\$ 8,352	\$ 8,877
<u>\$ 8,352</u>	<u>\$ 8,877</u>
<u>\$ -</u>	<u>\$ -</u>
\$ 341,130	\$ 337,128
2.45%	2.63%

City of Shepherd, Texas

SCHEDULE OF CHANGES IN POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB) LIABILITY AND RELATED RATIOS TEXAS MUNICIPAL RETIREMENT SYSTEM SUPPLEMENTAL DEATH BENEFITS PLAN

December 31,

	<u>12/31/2017</u>	<u>12/31/2018</u> ¹
Total OPEB liability		
Service cost	\$ 1,655	\$ 1,954
Interest	515	577
Changes in benefit terms	-	-
Differences between expected and actual experience	-	45
Changes of assumptions	1,470	(1,425)
Benefit payments, including refunds of participant contributions	-	-
Net change in total OPEB liability	<u>3,640</u>	<u>1,151</u>
Total OPEB liability - beginning	<u>\$ 12,809</u>	<u>\$ 16,449</u>
Total OPEB liability - ending (a)	<u><u>\$ 16,449</u></u>	<u><u>\$ 17,600</u></u> ²
Covered payroll	\$ 324,417	\$ 342,889
City's total OPEB liability as a percentage of covered payroll	5.07%	5.13%

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.

² No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB statement No. 75 to pay related benefits.

See Notes to Financial Statements.