

ANNUAL FINANCIAL REPORT

of the

City of Shepherd, Texas

**For the Year Ended
September 30, 2020**

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City of Shepherd, Texas

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September 30, 2020

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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, 2020, 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, 2020 and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the 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.

Brooks Watson & Co.

Brooks Watson & Co., PLLC
Certified Public Accountants
Houston, Texas
September 9, 2021

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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, 2020

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, 2020. 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 \$4,690,163 at September 30, 2020. Of this, \$1,432,960 (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 \$623,177 or 147% of total general fund expenditures.
- The City had an overall increase in net position of \$20,060.
- The City closed the year with a net pension asset of \$161,726.

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, 2020

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 fund. 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, 2020

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 \$4,690,163 as of September 30, 2020, in the primary government.

The largest portion of the City's net position, \$2,859,919 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, 2020

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:

	2020			2019		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Current and other assets	\$ 812,070	\$ 1,106,354	\$ 1,918,424	\$ 710,942	\$ 1,053,094	\$ 1,764,036
Long-term assets	1,895,363	2,303,287	4,198,650	1,956,072	2,424,827	4,380,899
Total Assets	<u>2,707,433</u>	<u>3,409,641</u>	<u>6,117,074</u>	<u>2,667,014</u>	<u>3,477,921</u>	<u>6,144,935</u>
Deferred Outflows of Resources	<u>4,834</u>	<u>7,867</u>	<u>12,701</u>	<u>17,997</u>	<u>29,284</u>	<u>47,281</u>
Other liabilities	61,467	223,774	285,241	82,298	217,277	299,575
Long-term liabilities	10,379	1,104,189	1,114,568	7,520	1,188,043	1,195,563
Total Liabilities	<u>71,846</u>	<u>1,327,963</u>	<u>1,399,809</u>	<u>89,818</u>	<u>1,405,320</u>	<u>1,495,138</u>
Deferred Inflows of Resources	<u>15,151</u>	<u>24,652</u>	<u>39,803</u>	<u>10,268</u>	<u>16,707</u>	<u>26,975</u>
Net Position:						
Net investment in capital assets	1,833,801	1,026,118	2,859,919	1,915,586	1,095,552	3,011,138
Restricted	129,884	267,400	397,284	125,073	263,199	388,272
Unrestricted	661,585	771,375	1,432,960	544,266	726,427	1,270,693
Total Net Position	<u>\$ 2,625,270</u>	<u>\$ 2,064,893</u>	<u>\$ 4,690,163</u>	<u>\$ 2,584,925</u>	<u>\$ 2,085,178</u>	<u>\$ 4,670,103</u>

Long-term assets decreased by \$182,249 primarily due to annual depreciation on capital assets exceeding new asset purchases. Total liabilities decreased by \$95,329 due to current year principal payments.

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2020

Statement of Activities:

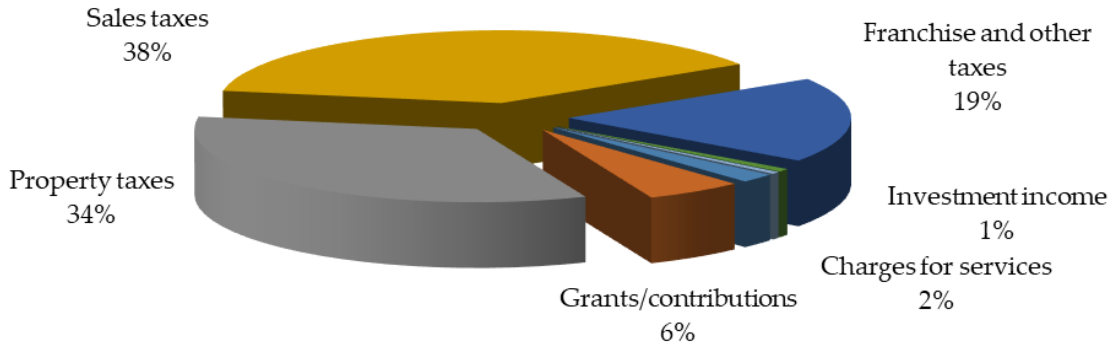
The following table provides a summary of the City's changes in net position:

	For the Year Ended September 30, 2020			For the Year Ended September 30, 2019		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
			Primary Government			Primary Government
Revenues						
Program revenues:						
Charges for services	\$ 11,113	\$ 842,049	\$ 853,162	\$ 24,111	\$ 827,466	\$ 851,577
Grants/contributions	30,495	-	30,495	-	-	-
General revenues:						
Property taxes	185,224	-	185,224	186,991	-	186,991
Sales taxes	209,127	-	209,127	175,936	-	175,936
Franchise and other taxes	102,942	-	102,942	119,877	-	119,877
Investment income	3,896	2,185	6,081	3,682	2,820	6,502
Other revenues	2,684	-	2,684	12,126	-	12,126
Total Revenues	545,481	844,234	1,389,715	522,723	830,286	1,353,009
Expenses						
General government	243,153	-	243,153	254,556	-	254,556
Public safety	51,109	-	51,109	65,748	-	65,748
Highways and streets	75,840	-	75,840	101,001	-	101,001
Culture and recreation	135,034	-	135,034	172,568	-	172,568
Interest and fiscal charges	-	18,487	18,487	-	23,197	23,197
Water and sewer	-	846,032	846,032	-	817,451	817,451
Total Expenses	505,136	864,519	1,369,655	593,873	840,648	1,434,521
Change in Net Position	40,345	(20,285)	20,060	(71,150)	(10,362)	(81,512)
Beginning Net Position	2,584,925	2,085,178	4,670,103	2,656,075	2,095,540	4,751,615
Ending Net Position	\$ 2,625,270	\$ 2,064,893	\$ 4,690,163	\$ 2,584,925	\$ 2,085,178	\$ 4,670,103

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2020

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

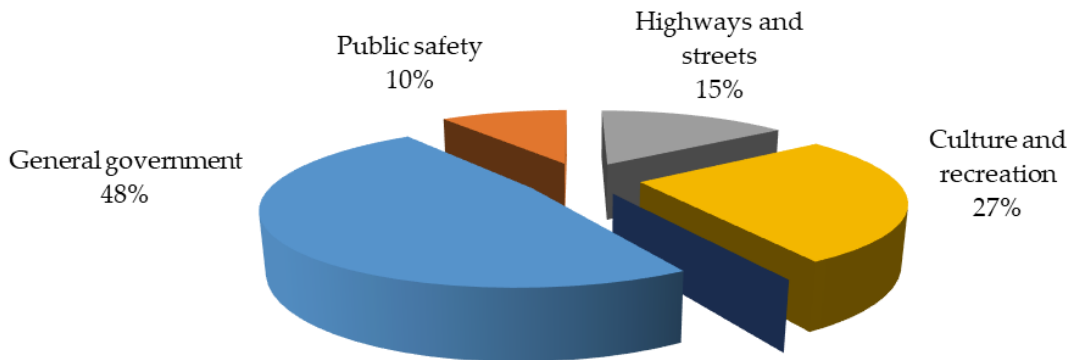
Governmental Activities - Revenues



For the year ended September 30, 2020, revenues from governmental activities totaled \$545,481. Property tax and sales tax are the City's largest revenue sources. Charges for services decreased by \$12,998 or 54% primarily due to a reduction in community center fees resulting from the shutdowns during the COVID-19 pandemic. Grants and contributions increased by \$30,495 or 100% due to nonrecurring public safety related grant funds received in the current year. Sales taxes increased by \$33,191 or 19% primarily as a result of economic growth fueled by local purchases. Franchise and other taxes decreased by \$16,935 or 14% primarily due to the impact of COVID-19. Other revenues decreased by \$9,442 or 78% as a direct result of decreased occupancy tax received in the current year due to the COVID-19 shutdowns. 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



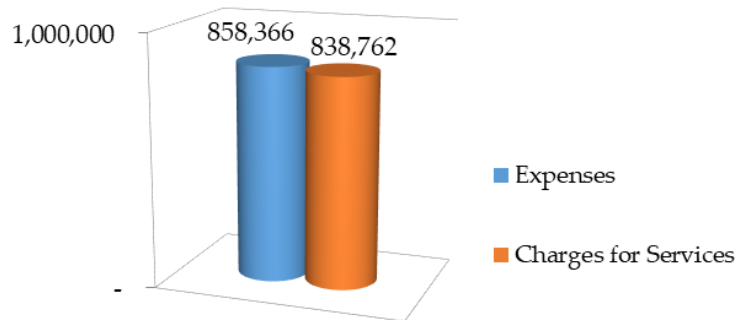
For the year ended September 30, 2020, expenses for governmental activities totaled \$505,136. This represents a decrease of \$88,737 or 15% from the prior year. The City's largest functional expense is

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2020

general governmental of \$243,153, which decreased slightly by \$11,403 or 4%, and is considered minimal. Public safety expenses decreased by \$14,639 or 22% due to the timing of an interlocal agreement. Highways and streets decreased by \$25,161 or 25% primarily due to nonrecurring street maintenance expenses in the prior year. Culture and recreation expenses decreased by \$37,534 or 22% primarily due to a reduction in personnel costs resulting from library closures during COVID-19. All other expenditures remained relatively consistent with the previous year.

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, 2020, charges for services by business-type activities totaled \$842,049. This is an increase of \$14,583 or 2%, which is considered consistent with the prior year.

Total business-type expenses posted an increase of \$23,871 or 3% compared to the prior year, which is considered minimal.

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 \$703,467. Unassigned fund balance totaled \$623,177 as of yearend. The general fund balance increased by \$127,589 due to greater than anticipated revenues and less than anticipated expenditures.

City of Shepherd, Texas
MANAGEMENT'S DISCUSSION AND ANALYSIS, Continued
September 30, 2020

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

GENERAL FUND BUDGETARY HIGHLIGHTS

There was a total positive revenue variance of \$93,954 and a positive expenditure variance of \$112,107 for the year. This positive revenue variance was primarily the result of greater property taxes, sales taxes, and other revenue compared to the final budget. No expenditures exceeded appropriations at the legal level of control. 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 \$1,833,801 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 \$2,203,123 in a variety of capital assets and infrastructure, net of accumulated depreciation. Major capital asset additions during the current year include the following:

- Purchased new sewer system equipment totaling \$41,419.
- Purchased trailer for \$10,959.
- Purchased new equipment for water system totaling \$17,112.

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, notes, and leases outstanding of \$1,177,005. During the year, the City made payments on the long-term debt of \$86,396. 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 considering the budget impacts from the aftermath 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, 2020

	Primary Government			Component
	Governmental	Business-Type	Total	Unit
	Activities	Activities		Shepherd EDC
Assets				
Current assets:				
Cash and cash equivalents	\$ 238,450	\$ 338,657	\$ 577,107	\$ 381,977
Restricted cash	80,290	186,708	266,998	-
Investments	380,761	460,622	841,383	238,295
Receivables, net	112,876	120,060	232,936	398
Due from primary government	-	-	-	49,052
Internal balances	(307)	307	-	-
Total Current Assets	812,070	1,106,354	1,918,424	669,722
Capital assets:				
Non-depreciable	295,390	11,710	307,100	69,317
Net depreciable capital assets	1,538,411	2,191,413	3,729,824	335,027
Net pension asset	61,562	100,164	161,726	-
Total Noncurrent Assets	1,895,363	2,303,287	4,198,650	404,344
Total Assets	2,707,433	3,409,641	6,117,074	1,074,066
Deferred Outflows of Resources				
Pension outflows	3,183	5,180	8,363	-
OPEB outflows	1,651	2,687	4,338	-
Total Deferred Outflows of Resources	4,834	7,867	12,701	-

See Notes to Financial Statements.

City of Shepherd, Texas
STATEMENT OF NET POSITION (Page 2 of 2)
September 30, 2020

	Primary Government			Component
	Governmental	Business-Type	Total	Unit
	Activities	Activities		Shepherd EDC
<u>Liabilities</u>				
Current liabilities:				
Accounts payable and accrued liabilities	\$ 6,278	\$ 12,790	\$ 19,068	\$ 1,406
Customer deposits	-	111,280	111,280	-
Accrued interest payable	-	7,721	7,721	-
Due to component unit	49,052	-	49,052	-
Compensated absences, current	6,137	3,054	9,191	-
Long-term debt, current	-	88,929	88,929	-
	<u>61,467</u>	<u>223,774</u>	<u>285,241</u>	<u>1,406</u>
Noncurrent liabilities:				
OPEB liability	9,697	15,774	25,471	-
Compensated absences, noncurrent	682	339	1,021	-
Long-term debt, noncurrent	-	1,088,076	1,088,076	-
	<u>10,379</u>	<u>1,104,189</u>	<u>1,114,568</u>	<u>-</u>
Total Liabilities	<u>71,846</u>	<u>1,327,963</u>	<u>1,399,809</u>	<u>1,406</u>
<u>Deferred Inflows of Resources</u>				
Pension inflows	15,151	24,652	39,803	-
Total Deferred Inflows of Resources	<u>15,151</u>	<u>24,652</u>	<u>39,803</u>	<u>-</u>
<u>Net Position</u>				
Net investment in capital assets	1,833,801	1,026,118	2,859,919	404,344
Restricted for:				
Grants	80,290	-	80,290	-
Pensions	49,594	80,692	130,286	-
Debt service	-	186,708	186,708	-
Economic development	-	-	-	668,316
Unrestricted	661,585	771,375	1,432,960	-
Total Net Position	<u>\$ 2,625,270</u>	<u>\$ 2,064,893</u>	<u>\$ 4,690,163</u>	<u>\$ 1,072,660</u>

See Notes to Financial Statements.

City of Shepherd, Texas

STATEMENT OF ACTIVITIES

For the Year Ended September 30, 2020

Functions/Programs	Expenses	Program Revenues	
		Charges for Services	Operating Grants and Contributions
Primary Government			
Governmental Activities			
General government	\$ 243,153	\$ 6,154	\$ 262
Public safety	51,109	-	30,233
Highways and streets	75,840	4,959	-
Culture and recreation	135,034	-	-
Total Governmental Activities	505,136	11,113	30,495
Business-Type Activities			
Water and sewer	864,519	842,049	-
Total Business-Type Activities	864,519	842,049	-
Total Primary Government	\$ 1,369,655	\$ 853,162	\$ 30,495
Component Unit			
Shepherd EDC	34,332	-	-
Total Component Unit	\$ 34,332	-	\$ -

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
\$ (236,737)	\$ -	\$ (236,737)	\$ -
(20,876)	-	(20,876)	-
(70,881)	-	(70,881)	-
(135,034)	-	(135,034)	-
<u>(463,528)</u>	<u>-</u>	<u>(463,528)</u>	<u>-</u>
-	(22,470)	(22,470)	-
-	(22,470)	(22,470)	-
<u>(463,528)</u>	<u>(22,470)</u>	<u>(485,998)</u>	<u>-</u>
			(34,332)
			<u>\$ (34,332)</u>
185,224	-	185,224	-
209,127	-	209,127	104,563
102,942	-	102,942	-
3,896	2,185	6,081	2,962
2,684	-	2,684	32,650
<u>503,873</u>	<u>2,185</u>	<u>506,058</u>	<u>140,175</u>
40,345	(20,285)	20,060	105,843
2,584,925	2,085,178	4,670,103	966,817
<u>\$ 2,625,270</u>	<u>\$ 2,064,893</u>	<u>\$ 4,690,163</u>	<u>\$ 1,072,660</u>

City of Shepherd, Texas

BALANCE SHEET GOVERNMENTAL FUND September 30, 2020

	<u>General</u>
<u>Assets</u>	
Cash and cash equivalents	\$ 238,450
Restricted cash	80,290
Investments	380,761
Receivables, net	112,876
Total Assets	\$ 812,377
<u>Liabilities</u>	
Accounts payable and accrued liabilities	\$ 6,278
Due to other funds	307
Due to component unit	49,052
Total Liabilities	55,637
<u>Deferred Inflows of Resources</u>	
Unavailable revenue: Property tax	53,273
Total Deferred Inflows of Resources	53,273
<u>Fund Balances</u>	
Restricted for: Grants	80,290
Unassigned reported in: General fund	623,177
Total Fund Balances	703,467
Total Liabilities and Fund Balances	\$ 759,104

See Notes to Financial Statements.

City of Shepherd, Texas

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

September 30, 2020

Fund Balances - Total Governmental Funds	\$ 703,467
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	1,538,411
Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the governmental funds.	
Property tax receivable	53,273
Net pension asset	61,562
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	2,313
Difference in pension assumptions	870
OPEB investment experience	253
OPEB difference in expected and actual experience	1,398
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.	
Pension investment returns	(8,809)
Pension difference in expected and actual experience	(6,342)
Some liabilities, including bonds payable and capital leases, are not reported as liabilities in the governmental funds.	
Compensated absences	(6,819)
OPEB liability	(9,697)
Net Position of Governmental Activities	\$ 2,625,270

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, 2020

	<u>General</u>
<u>Revenues</u>	
Property tax	\$ 192,097
Sales tax	209,127
Franchise and other taxes	102,942
Intergovernmental	262
Charges for services	6,154
License and permits	4,959
Investment income	3,896
Contributions and donations	684
Other revenue	32,233
Total Revenues	<u>552,354</u>
<u>Expenditures</u>	
Current:	
General government:	221,659
Municipal court	45,259
Highway and streets	23,395
Culture and recreation	134,452
Total Expenditures	<u>424,765</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	127,589
Net Change in Fund Balances	<u>127,589</u>
Beginning fund balances	575,878
Ending Fund Balances	<u><u>\$ 703,467</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, 2020

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

Net changes in fund balances - total governmental funds	\$ 127,589
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.	
Depreciation expense	(81,785)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	
	(6,873)
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	1,381
Pension expense	1,326
OPEB expense	(1,293)
Change in Net Position of Governmental Activities	\$ 40,345

See Notes to Financial Statements.

City of Shepherd, Texas
STATEMENT OF NET POSITION (Page 1 of 2)
PROPRIETARY FUND
September 30, 2020

	<u>Water and Sewer Fund</u>
<u>Assets</u>	
<u>Current Assets</u>	
Cash and cash equivalents	\$ 338,657
Restricted cash	186,708
Investments	460,622
Receivables, net	120,060
Due from other funds	307
Total Current Assets	<u>1,106,354</u>
<u>Noncurrent Assets</u>	
Capital assets:	
Non-depreciable	11,710
Net depreciable capital assets	2,191,413
Net pension asset	100,164
Total Noncurrent Assets	<u>2,303,287</u>
Total Assets	<u>3,409,641</u>
 <u>Deferred Outflows of Resources</u>	
Pension outflows	5,180
OPEB outflows	2,687
Total Deferred Outflows of Resources	<u>7,867</u>

City of Shepherd, Texas
STATEMENT OF NET POSITION (Page 2 of 2)
PROPRIETARY FUND
September 30, 2020

	Water and Sewer Fund
<u>Liabilities</u>	
<u>Current Liabilities</u>	
Accounts payable and accrued liabilities	\$ 12,790
Customer deposits	111,280
Accrued interest	7,721
Compensated absences, current	3,054
Long-term debt, current	88,929
Total Current Liabilities	223,774
<u>Noncurrent Liabilities</u>	
OPEB liability	15,774
Compensated absences, noncurrent	339
Long-term debt, noncurrent	1,088,076
Total Noncurrent Liabilities	1,104,189
Total Liabilities	1,327,963
<u>Deferred Inflows of Resources</u>	
Pension inflows	24,652
Total Deferred Inflows of Resources	24,652
<u>Net Position</u>	
Net investment in capital assets	1,026,118
Restricted for pensions	80,692
Restricted for debt service	186,708
Unrestricted	771,375
Total Net Position	\$ 2,064,893

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, 2020

	<u>Water and Sewer Fund</u>
<u>Operating Revenues</u>	
Water sales	\$ 594,420
Sewer sales	247,629
Total Operating Revenues	<u>842,049</u>
<u>Operating Expenses</u>	
Administration	124,720
Water department	250,349
Sewer department	255,947
Depreciation	215,016
Total Operating Expenses	<u>846,032</u>
Operating Income (Loss)	<u>(3,983)</u>
<u>Nonoperating Revenues (Expenses)</u>	
Investment income	2,185
Interest expense	(18,487)
Total Nonoperating Revenues (Expenses)	<u>(16,302)</u>
Change in Net Position	<u>(20,285)</u>
Beginning net position	2,085,178
Ending Net Position	<u>\$ 2,064,893</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, 2020

	<u>Water and Sewer Fund</u>
<u>Cash Flows from Operating Activities</u>	
Receipts from customers	\$ 840,716
Payments to suppliers	(343,275)
Payments to employees	(283,442)
Net Cash Provided by Operating Activities	<u>213,999</u>
<u>Cash Flows from Capital and Related Financing Activities</u>	
Capital purchases	(59,186)
Principal paid on debt	(86,396)
Interest paid on debt	(21,505)
Net Cash (Used) by Capital and Related Financing Activities	<u>(167,087)</u>
<u>Cash Flows from Investing Activities</u>	
Purchase of investments	(1,594)
Interest on investments	2,185
Net Cash Provided by Investing Activities	<u>591</u>
Increase (Decrease) in Cash and Cash Equivalents	47,503
Beginning cash and cash equivalents	477,862
Ending Cash and Cash Equivalents	<u><u>\$ 525,365</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, 2020

	<u>Water and Sewer Fund</u>
<u>Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities</u>	
Operating Income (Loss)	\$ (3,983)
Adjustments to reconcile operating income (loss) to net cash provided:	
Depreciation	215,016
Changes in Operating Assets and Liabilities:	
(Increase) Decrease in:	
Accounts receivable	(3,856)
Deferred Outflows of Resources:	
Pension asset	24,080
OPEB liability	(2,663)
Increase (Decrease) in:	
Accounts payable and accrued liabilities	4,660
Customer deposits	2,523
Net pension liability (asset)	(34,290)
OPEB liability	4,874
Deferred Inflows of Resources:	
Pension asset	8,054
OPEB liability	(109)
Net Cash Provided by Operating Activities	\$ 213,999

See Notes to Financial Statements.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS
September 30, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

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, 2020

level. No funds can be transferred or added to a budgeted fund without Council approval. Appropriations lapse at the end of the year. For the year ended September 30, 2020, actual expenditures did not exceed appropriations at the legal level of control.

IV. DETAILED NOTES ON ALL FUNDS

A. Deposits and Investments

As of September 30, 2020, the primary government had the following investments:

<u>Investment Type</u>	<u>Carrying Value</u>	<u>Average Maturity (Years)</u>
Certificates of deposit	\$ 841,383	0.33
Total carrying value	<u>\$ 841,383</u>	
Portfolio weighted average maturity		0.33

As of September 30, 2020, 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	\$ 238,295	0.57
Total carrying value	<u>\$ 238,295</u>	
Portfolio weighted average maturity		0.57

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.

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, 2020, 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, 2020, the market values of pledged securities and FDIC exceeded bank balances.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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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.

C. Receivables

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

	General	Water and Sewer	Total
Property taxes	\$ 53,273	\$ -	\$ 53,273
Sales tax	55,918	-	55,918
Franchise and other taxes	3,685	-	3,685
Accounts	-	144,004	144,004
Allowance	-	(23,944)	(23,944)
	<u>\$ 112,876</u>	<u>\$ 120,060</u>	<u>\$ 232,936</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

D. Capital Assets

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

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases/ Reclassifications</u>	<u>Ending Balances</u>
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	1,087,938	-	-	1,087,938
Furniture and equipment	64,866	-	-	64,866
Vehicles, machinery & equipment	181,346	-	-	181,346
Infrastructure	1,085,989	-	-	1,085,989
Total capital assets being depreciated	<u>2,420,139</u>	<u>-</u>	<u>-</u>	<u>2,420,139</u>
Less accumulated depreciation				
Buildings and improvements	(278,403)	(21,145)	-	(299,548)
Furniture and equipment	(57,488)	(2,346)	-	(59,834)
Vehicles, machinery & equipment	(139,163)	(8,667)	-	(147,830)
Infrastructure	(324,889)	(49,627)	-	(374,516)
Total accumulated depreciation	<u>(799,943)</u>	<u>(81,785)</u>	<u>-</u>	<u>(881,728)</u>
Net capital assets being depreciated	1,620,196	(81,785)	-	1,538,411
Total Net Capital Assets	<u>\$ 1,915,586</u>	<u>\$ (81,785)</u>	<u>\$ -</u>	<u>\$ 1,833,801</u>

Depreciation was charged to governmental functions as follows:

General government	\$ 22,908
Public safety	5,850
Highways and streets	52,445
Culture and recreation	582
Total Governmental Activities Depreciation Expense	<u>\$ 81,785</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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A summary of changes in business-type activities capital assets for the year was as follows:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases/ Reclassifications</u>	<u>Ending Balances</u>
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	2,466,194	6,808	-	2,473,002
Sewer system	4,264,587	41,419	-	4,306,006
Buildings and improvements	28,501	-	-	28,501
Vehicles, machinery and equipment	477,979	10,959	-	488,938
Total capital assets being depreciated	<u>7,237,261</u>	<u>59,186</u>	<u>-</u>	<u>7,296,447</u>
Less accumulated depreciation				
Water system	(1,846,762)	(41,232)	-	(1,887,994)
Sewer system	(2,778,219)	(132,994)	-	(2,911,213)
Buildings and improvements	(28,501)	-	-	(28,501)
Vehicles, machinery and equipment	(236,536)	(40,790)	-	(277,326)
Total accumulated depreciation	<u>(4,890,018)</u>	<u>(215,016)</u>	<u>-</u>	<u>(5,105,034)</u>
Net capital assets being depreciated	<u>2,347,243</u>	<u>(155,830)</u>	<u>-</u>	<u>2,191,413</u>
Total Net Capital Assets	<u><u>\$ 2,358,953</u></u>	<u><u>\$ (155,830)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 2,203,123</u></u>

Depreciation was charged to business-type functions as follows:

Water	\$ 82,022
Sewer	132,994
Total Business-type Activities Depreciation Expense	<u><u>\$ 215,016</u></u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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A summary of changes in component unit activities capital assets for the year was as follows:

	<u>Beginning Balances</u>	<u>Increases</u>	<u>Decreases/ Reclassifications</u>	<u>Ending Balances</u>
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	(48,547)	(8,071)	-	(56,618)
Total accumulated depreciation	<u>(48,547)</u>	<u>(8,071)</u>	<u>-</u>	<u>(56,618)</u>
Net capital assets being depreciated	343,098	(8,071)	-	335,027
Total Net Capital Assets	<u>\$ 412,415</u>	<u>\$ (8,071)</u>	<u>\$ -</u>	<u>\$ 404,344</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

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.

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Business-Type Activities:					
Bonds and other payables:					
Certificates of obligation	\$ 502,000	\$ -	\$ (17,000)	\$ 485,000	\$ 18,000
Capital lease payable	101,859	-	(32,396)	69,463	33,929
Note payable	659,542	-	(37,000)	622,542	37,000
Total Business-Type Activities	<u>\$ 1,263,401</u>	<u>\$ -</u>	<u>\$ (86,396)</u>	<u>\$ 1,177,005</u>	<u>\$ 88,929</u>
Long-term liabilities due in more than one year				<u>\$ 1,088,076</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, 2020:

	<u>Business - Type Activities</u>	<u>Total</u>
Capital Lease Obligations:		
\$170,005 Lease agreement with Kubota, due in annual installments through 2022, interest at 4.73%	\$ 69,463	\$ 69,463
Total Capital Lease Obligations	<u>\$ 69,463</u>	<u>\$ 69,463</u>
Certificates of Obligation:		
\$720,000 Certificates of Obligation, Series 1999, due in annual installments through 2038, interest at 3.25%	\$ 485,000	\$ 485,000
Total Certificates of Obligation	<u>\$ 485,000</u>	<u>\$ 485,000</u>
Notes Payable:		
\$773,742 Note payable to TXDOT, due in annually installments of \$37,200 through 2037, interest at 0%	\$ 622,542	\$ 622,542
Total Notes Payable	<u>\$ 622,542</u>	<u>\$ 622,542</u>
Total Long-term Debt	<u>\$ 1,177,005</u>	<u>\$ 1,177,005</u>

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

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

<u>Year ending September 30,</u>	<u>Certificates of Obligation</u>		<u>Note Payable</u>		<u>Total</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2021	\$ 18,000	\$ 15,870	\$ 37,000	\$ -	\$ 55,000	\$ 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	27,542	-	63,542	2,389
2038	37,000	1,211	-	-	37,000	1,211
	<u>\$ 485,000</u>	<u>\$ 168,318</u>	<u>\$ 622,542</u>	<u>\$ -</u>	<u>\$ 1,107,542</u>	<u>\$ 168,318</u>

<u>Year ending September 30,</u>	<u>Capital Lease</u>		<u>Total</u>
	<u>Principal</u>	<u>Interest</u>	
2021	\$ 33,929	\$ 3,283	\$ 37,212
2022	35,534	1,679	37,213
	<u>\$ 69,463</u>	<u>\$ 4,962</u>	<u>\$ 74,425</u>

The asset under capital lease had an original book value of \$170,005 and a net book value of \$103,217 as of September 30, 2020. 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, 2020

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	\$ 8,200	\$ -	\$ (1,381)	\$ 6,819	\$ 6,137
Total Governmental Activities	<u>\$ 8,200</u>	<u>\$ -</u>	<u>\$ (1,381)</u>	<u>\$ 6,819</u>	<u>\$ 6,137</u>
Other Long-term Liabilities Due in More than One Year				<u>\$ 682</u>	
Business-Type Activities:					
Compensated Absences	\$ 3,393	\$ -	\$ -	\$ 3,393	\$ 3,054
Total Business-Type Activities	<u>\$ 3,393</u>	<u>\$ -</u>	<u>\$ -</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 \$111,280 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	\$ -	\$ 186,708
Grant funds	80,290	-
Total restricted assets	<u>\$ 80,290</u>	<u>\$ 186,708</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 \$485,000 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
September 30, 2020

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 888 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 2019</u>	<u>Plan Year 2018</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, 2019 valuation and measurement date, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	3
Inactive employees entitled to but not yet receiving benefits	8
Active employees	<u>10</u>
Total	<u>21</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 2.70% and 2.59% in calendar years 2019 and 2020, respectively. The City's contributions to TMRS for the year ended September 30, 2020, were \$8,336, 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, 2019, 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, 2019 actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.5% per year
Overall payroll growth	2.75% per year
Investment Rate of Return	6.75% net of pension plan investment expense, including inflation

Salary increases are based on a service-related table. Mortality rates for active members are based on the PUB(10) mortality tables with the Public Safety table used for males and the General Employee table used for females. Mortality rates for healthy retirees and beneficiaries are based on the Gender-distinct 2019 Municipal Retirees of Texas mortality tables. The rates for actives, healthy retirees and beneficiaries are projected on a fully generational basis by Scale UMP to account for future mortality improvements. For disabled annuitants, the same mortality tables for healthy retirees is used with a 4-year set-forward for males and a 3-year set-forward for females. In addition, a 3.5% and 3.0% minimum 16 mortality rate is applied, for males and females respectively, to reflect the impairment for younger members who become disabled. The rates are projected on a fully generational basis by Scale UMP to account for future mortality improvements subject to the floor.

The actuarial assumptions were developed primarily from the actuarial investigation of the experience of TMRS over the four-year period from December 31, 2014 to December 31, 2018. They were adopted in 2019 and first used in the December 31, 2019 actuarial valuation. The post-retirement mortality assumption for Annuity Purchase Rates (APRs) is based on the Mortality

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
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Experience Investigation Study covering 2009 through 2011 and dated December 31, 2013. 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 2020 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, 2020

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%
\$ (87,819)	\$ (161,726)	\$ (223,649)

Changes in the Net Pension Liability (Asset)

	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension (Asset) Liability (a) – (b)
Balance at 12/31/18	\$ 564,849	\$ 671,209	\$ (106,360)
Changes for the year:			
Service cost	40,984	-	40,984
Interest	38,642	-	38,642
Difference between expected and actual experience	1,569	-	1,569
Contributions – employer	-	9,364	(9,364)
Contributions – employee	-	24,008	(24,008)
Net investment income	-	103,846	(103,846)
Change of assumptions	52	-	52
Benefit payments, including refunds of emp. contributions	(25,727)	(25,727)	-
Administrative expense	-	(586)	586
Other changes	-	(19)	19
Net changes	55,520	110,886	(55,366)
Balance at 12/31/19	\$ 620,369	\$ 782,095	\$ (161,726)

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, 2020, the City recognized pension expense of \$4,954.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

At September 30, 2020, 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	\$ 2,285	\$ -
Difference in expected vs. actual experience	-	(16,660)
Investment returns	-	(23,143)
Contributions subsequent to the measurement date	6,078	-
Total	\$ 8,363	\$ (39,803)

The City reported \$6,078 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, 2021. 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:

2020	\$ (13,250)
2021	(10,046)
2022	(1,779)
2023	(12,443)
2024	-
Thereafter	-
	\$ (37,518)

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 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, paragraph 4b, (i.e., no assets are accumulated for OPEB). As such, the SDBF is considered to be a single-employer unfunded OPEB plan (and not a cost sharing plan) with benefit payments treated as being equal to the employer's yearly contributions for retirees.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

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 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, 2019 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	3
Active employees	10
Total	15

The City's retiree contributions to the TMRS SDBF for the fiscal years ended 2020, 2019 and 2018 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
2018	0.00%	0.00%	N/A
2019	0.00%	0.00%	N/A
2020	0.01%	0.01%	N/A

Total OPEB Liability

The City's Postemployment Benefits Other Than Pensions Liability (OPEB) was measured as of December 31, 2019, 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, 2019 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

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

Discount rate	2.75%
Retirees' share of benefit-related costs	\$0
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 2.75%. The discount rate was based on the Fidelity Index's "20-Year Municipal GO AA Index" rate as of December 31, 2019.

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 2.75%, 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 (1.75%) or 1-percentage-point higher (3.75%) than the current rate:

1% Decrease (1.75%)	Current Single Rate Assumption 2.75%	1% Increase (3.75%)
\$ 31,752	\$ 25,471	\$ 20,742

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

Changes in the Total OPEB Liability:

	Total OPEB Liability
Balance at 12/31/18	\$ 17,600
Changes for the year:	
Service Cost	1,783
Interest	686
Difference between expected and actual experience	755
Changes of assumptions	4,647
Benefit payments	-
Net changes	7,871
Balance at 12/31/19	\$ 25,471

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

For the year ended September 30, 2020, the City recognized OPEB expense of \$3,393.

At September 30, 2020, the City reported deferred outflows of resources related to the OPEB liability from the following sources:

	Deferred Outflows of Resources
Differences between expected and actual economic experience	\$ 665
Change in assumptions	3,673
Total	\$ 4,338

The City reported \$0 as deferred outflows of resources related to OPEB resulting from contributions subsequent to the measurement date that will be recognized as a reduction of the OPEB liability for the year ending September 30, 2021.

City of Shepherd, Texas
NOTES TO FINANCIAL STATEMENTS, Continued
September 30, 2020

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

Year ended December 31:	
2020	\$ 924
2021	924
2022	924
2023	883
2024	683
Thereafter	-
	\$ 4,338

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, 2020.

G. Subsequent Events

There were no material subsequent events through September 9, 2021, the date the financial statements were issued.

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, 2020

	Original & Final Budget	Actual	Variance with Final Budget Positive (Negative)
<u>Revenues</u>			
Property tax	\$ 174,000	\$ 192,097	\$ 18,097
Sales tax	150,000	209,127	59,127
Franchise and other taxes	105,000	102,942	(2,058)
Intergovernmental	-	262	262
Charges for services	9,300	6,154	(3,146)
License and permits	10,000	4,959	(5,041)
Fines and forfeitures	1,100	-	(1,100)
Investment income	2,000	3,896	1,896
Contributions and donations	2,000	684	(1,316)
Other revenue	5,000	32,233	27,233
Total Revenues	458,400	552,354	93,954
<u>Expenditures</u>			
Current:			
General government:	253,066	221,659	31,407
Municipal court	66,300	45,259	21,041
Highway and streets	49,000	23,395	25,605
Culture and recreation	168,506	134,452	34,054
Total Expenditures	536,872	424,765	112,107
Revenues Over (Under) Expenditures	(78,472)	127,589	206,061
Net Change in Fund Balance	\$ (78,472)	127,589	\$ 206,061
Beginning fund balance		575,878	
Ending Fund Balance		\$ 703,467	

Notes to Required Supplementary Information

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

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.

	<u>2017</u>	<u>2018</u>	<u>2019</u>
	\$ 38,703	\$ 41,009	\$ 40,984
	32,918	36,726	38,642
	-	-	-
	2,237	(21,524)	1,569
	-	-	52
	(7,275)	(29,906)	(25,727)
	<u>66,583</u>	<u>26,305</u>	<u>55,520</u>
	<u>471,961</u>	<u>538,544</u>	<u>564,849</u>
	<u>538,544</u>	<u>564,849</u>	<u>620,369</u>
	\$ 8,407	\$ 8,265	\$ 9,364
	22,709	24,002	24,008
	81,151	(20,680)	103,846
	(7,275)	(29,906)	(25,727)
	(420)	(399)	(586)
	(23)	(22)	(19)
	<u>104,549</u>	<u>(18,740)</u>	<u>110,886</u>
	<u>585,400</u>	<u>689,949</u>	<u>671,209</u>
	<u>\$ 689,949</u>	<u>\$ 671,209</u>	<u>\$ 782,095</u>
	<u><u>\$ (151,405)</u></u>	<u><u>\$ (106,360)</u></u>	<u><u>\$ (161,726)</u></u>
	128%	119%	126%
	\$ 324,417	\$ 342,889	\$ 342,964
	-47%	-31%	-47%

City of Shepherd, Texas

SCHEDULE OF EMPLOYER CONTRIBUTIONS TO PENSION PLAN

Years Ended:

	9/30/2015	9/30/2016	9/30/2017
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	N/A
Asset Valuation Method	10 Year smoothed market; 12% soft corridor
Inflation	2.5%
Salary Increases	3.50% to 11.5% 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 2019 valuation pursuant to an experience study of the period 2014 - 2018

Mortality

Post-retirement: 2019 Municipal Retirees of Texas Mortality Tables. The rates are projected on a fully generational basis with scale UMP.

Pre-retirement: PUB(10) mortality tables, with the Public Safety table used for males and the General Employee table used for females. The rates are projected on a fully generational basis with scale UMP.

Other Information:

Notes There were no benefit changes during the year.

<u>9/30/2018</u>	<u>9/30/2019</u>	<u>9/30/2020</u> ¹
\$ 8,352	\$ 8,877	\$ 8,336
<u>\$ 8,352</u>	<u>\$ 8,877</u>	<u>\$ 8,336</u>
<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
\$ 341,130	\$ 337,128	\$ 318,310
2.45%	2.63%	2.62%

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,

	12/31/2017	12/31/2018	12/31/2019 ¹
Total OPEB liability			
Service cost	\$ 1,655	\$ 1,954	\$ 1,783
Interest	515	577	686
Differences between expected and actual experience	-	45	755
Changes of assumptions	1,470	(1,425)	4,647
Benefit payments, including refunds of participant contributions	-	-	-
Net change in total OPEB liability	3,640	1,151	7,871
Total OPEB liability - beginning	\$ 12,809	\$ 16,449	\$ 17,600
Total OPEB liability - ending	\$ 16,449	\$ 17,600	\$ 25,471 ²
 Covered payroll	 \$ 324,417	 \$ 342,889	 \$ 342,964
City's total OPEB liability as a percentage of covered payroll	 5.07%	 5.13%	 7.43%

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.