

CITY OF HORSESHOE BAY, TEXAS  
BASIC FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION  
SEPTEMBER 30, 2007

CITY OF HORSESHOE BAY  
ANNUAL FINANCIAL REPORT  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

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# ***NEFFENDORF, KNOPP, HORRY & DOSS, P.C.***

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### Independent Auditor's Report

Honorable Mayor and Aldermen  
City of Horseshoe Bay, Texas  
Horseshoe Bay, TX 78657

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Horseshoe Bay, as of and for the year ended September 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Horseshoe Bay's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Horseshoe Bay, as of September 30, 2007, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (pages 3 through 8) and budgetary comparison (page 29) are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 5, 2008 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Horseshoe Bay's basic financial statements. The combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

NEFFENDORF, KNOPP, HORRY AND DOSS, P.C.

Fredericksburg, Texas

March 5, 2008

## MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the City of Horseshoe Bay, we offer readers of the City's financial statements this narrative overview and analysis of the financial statements of the City for the year ended September 30, 2007. Please read it in conjunction with the independent auditors' report on page 1, and City's Basic Financial Statements which begin on page 9.

### FINANCIAL HIGHLIGHTS

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by \$23,826,265 (net assets). Of this amount, \$7,070,573 (unrestricted net assets) may be used to meet the City's ongoing obligations to citizen's and creditors.
- The City's net assets increased by \$1,886,690 as a result of this period's operations.
- At September 30, 2007, the City's governmental funds reported combined ending fund balances of \$3,959,931.
- At September 30, 2007, the City's Utility Fund reported unrestricted net assets of \$2,998,774.

### USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The government-wide financial statements include the Statement of Net Assets and the Statement of Activities (on pages 9 and 10). These provide information about the activities of the City as a whole and present a longer-term view of the City's property and debt obligations and other financial matters. They reflect the flow of total economic resources in a manner similar to the financial reports of a business enterprise.

Fund financial statements (beginning on page 12) report the City's operations in more detail than the government-wide statements by providing information about the City's most significant funds. For governmental activities, these statements tell how services were financed in the short term as well as what resources remain for future spending. They reflect the flow of current financial resources, and supply the basis for tax levies and the appropriations budget.

The notes to the financial statements (starting on page 20) provide narrative explanations or additional data needed for full disclosure in the government-wide statements or the fund financial statements.

The Budgetary Comparison Schedule (general fund) is presented as required supplementary information on page 29.

## **Reporting the City as a Whole**

### ***The Statement of Net Assets and the Statement of Activities***

The analysis of the City's overall financial condition and operations begins on page 9. Its primary purpose is to show whether the City is better off or worse off as a result of the period's activities. The Statement of Net Assets includes all the City's assets and liabilities at the end of the year while the Statement of Activities includes all the revenues and expenses generated by the City's operations during the period. These apply the accrual basis of accounting which is the basis used by private sector companies.

All of the current period's revenues and expenses are taken into account regardless of when cash is received or paid. All the City's assets are reported whether they serve the current year or future years. Liabilities are considered regardless of whether they must be paid in the current or future years.

These two statements report the City's net assets and changes in them. The City's net assets (the difference between assets and liabilities) provide one measure of the City's financial health, or financial position. Over time, increases or decreases in the City's net assets are one indicator of whether its financial health is improving or deteriorating. To fully assess the overall health of the City, however, you should consider other factors as well, such as changes in the City's customers or its property tax base and the condition of the City's facilities.

In the Statement of Net Assets and the Statement of Activities, the City has two kinds of activity:

- Governmental activity - Most of the City's basic services are reported here, including the public safety, public works, municipal court and administration. Property taxes, user charges, sales tax and franchise tax finance most of these activities.
- Business-type activity - The City's utility system is reported as a business-type activity since the fees charged to customers cover the cost of services provided.

## **Reporting the City's Most Significant Funds**

### ***Fund Financial Statements***

The fund financial statements provide detailed information about the most significant funds - not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes.

The City has two kinds of funds:

- Governmental funds - All of the City's basic services are reported in governmental funds. These use modified accrual accounting (a method that measures the receipt and disbursement of cash and all other financial assets that can be readily converted to cash) and report balances that are available for future spending. The governmental fund statements provide a detailed short-term view of the City's general operations and the basic services it provides. We describe the differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in Note II to the financial statements.
- Proprietary funds - Services for which the City charges customers a fee are generally reported in proprietary funds. The City's enterprise fund (Utility) is a business-type activity and provides both long and short-term financial information.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

Our analysis focuses on the net assets (Table I) and changes in net assets (Table II) of the City's governmental and business-type activities.

Net assets of the City's governmental activities increased by \$1,334,452. Unrestricted net assets - the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements – was \$4,071,799 at September 30, 2007. This increase in governmental net assets was the result of three factors. First, the City's revenues exceeded the expenditures by \$1,413,559 (including transfers to the Utility Fund of \$1,560,000). Second, the City acquired capital assets in the amount of \$139,460. Third, the City recorded depreciation in the amounts of \$231,390.

Net assets of the City's business-type activities increased from \$17,276,307 to \$17,828,546. Unrestricted net assets were \$2,998,774 at September 30, 2007. This increase in business-type net assets was the result of net income of \$552,238 (including transfers from the general fund in the amount of \$1,560,000).

**Table I**  
**City of Horseshoe Bay**

**NET ASSETS**  
in thousands

	Governmental Activities	Business-Type Activities	TOTALS Primary Government
	<u>          </u>	<u>          </u>	<u>          </u>
Current and Other Assets	\$ 4,245	\$ 6,713	\$ 10,958
Capital Assets	1,926	21,697	23,623
Total Assets	<u>\$ 6,171</u>	<u>\$ 28,410</u>	<u>\$ 34,581</u>
Long-Term Liabilities	\$	\$ 7,500	\$ 7,500
Other Liabilities	173	3,081	3,254
Total Liabilities	<u>\$ 173</u>	<u>\$ 10,581</u>	<u>\$ 10,754</u>
Net Assets:			
Invested in Capital Assets			
Net of Related Debt	\$ 1,926	\$ 11,697	\$ 13,623
Restricted		3,133	3,133
Unrestricted	4,072	2,999	7,071
Total Net Assets	<u>\$ 5,998</u>	<u>\$ 17,829</u>	<u>\$ 23,827</u>

**Table II**  
**City of Horseshoe Bay**

**CHANGES IN NET ASSETS**  
in thousands

	Governmental Activities	Business-Type Activities	TOTALS Primary Government
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Revenues:			
Charges for Services	\$ 277	\$ 4,071	\$ 4,348
Stand-by Charges		101	101
Maintenance & Operations Taxes	4,826		4,826
Other Taxes	86		86
Penalty & Interest	49		49
Investment Earnings	239	293	532
Capital Grants	54		54
Miscellaneous	63	7	70
Total Revenue	<u>\$ 5,594</u>	<u>\$ 4,472</u>	<u>\$ 10,066</u>
Expenses:			
General Government	\$ 469	\$	\$ 469
Police	1,044		1,044
Fire	1,066		1,066
Development Services	120		120
Utilities		5,038	5,038
Debt Service		441	441
Total Expenses	<u>\$ 2,699</u>	<u>\$ 5,479</u>	<u>\$ 8,178</u>
Increase in Net Assets			
Before Transfers	\$ 2,895	\$ (1,077)	\$ 1,888
Transfers	<u>(1,560)</u>	<u>1,560</u>	<u>0</u>
Net Change	\$ 1,335	\$ 553	\$ 1,888
Net Assets - Beginning	<u>4,663</u>	<u>17,276</u>	<u>21,939</u>
Net Assets - Ending	<u>\$ 5,998</u>	<u>\$ 17,829</u>	<u>\$ 23,827</u>

## THE CITY'S FUNDS

As the City completed the year, its governmental funds (as presented in the balance sheet on page 12) reported a combined fund balance of \$3,959,931. Included in this year's total change in fund balance is an increase of \$1413,559 in the City's General Fund. The primary reasons for the General Fund's gain mirror the governmental activities analysis highlighted on page 5.

The City adopted the General Fund Budget. Actual revenues exceeded budgeted amounts by \$310,184, while actual expenditures were less than budgeted amounts by \$142,099.

## CAPITAL ASSET AND DEBT ADMINISTRATION

At September 30, 2007, the City had the following amounts invested in capital assets:

	Amount	Accumulated Depreciation
Governmental Activities	\$ 3,237,993	\$ 1,312,073
Business-Type Activities	\$ 35,665,902	\$ 13,969,226

This period's major additions included:

	Governmental Activities	Business Type Activities
Infrastructure	\$	\$ 1,061,252
Building	13,872	
Police Department	61,825	
Utilities Equipment		138,403
Fire – Brush Truck	63,763	
TOTALS	<u>\$ 139,460</u>	<u>\$ 1,199,655</u>

More detailed information about the City's capital assets is presented in Note D and E to the financial statements.

### Debt

For business-type activities, the City had \$10,000,000 in revenue notes outstanding.

More detailed information about the City's long-term liabilities is presented in Note F to the financial statements.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials considered many factors when setting the fiscal-year 2008 budget and tax rates. The major factors are the assessed property values and population growth. These indicators were taken into account when adopting the General Fund budget for 2008. Amounts available for appropriation in the General Fund budget are \$5,939,853 and expenditures are estimated to be \$5,378,555.

If these estimates are realized, the City's budgetary General fund balance is expected to increase by \$561,298 by the close of 2008.

## CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City's business office, at City of Horseshoe Bay, Horseshoe Bay, Texas.

CITY OF HORSESHOE BAY  
STATEMENT OF NET ASSETS  
SEPTEMBER 30, 2007

EXHIBIT A-1

	Primary Government		Total
	Governmental Activities	Business Type Activities	
<b>ASSETS</b>			
Cash and Cash Equivalents	\$ 31,503	\$ 155,270	\$ 186,773
Investments - Current	4,054,716	2,882,994	6,937,710
Receivables (net of allowance for uncollectibles)	138,138	470,171	608,309
Inventories	-	50,834	50,834
Prepaid Items	20,601	20,601	41,202
Restricted Assets:			
Temporarily Restricted:			
Note Debt Service	-	3,133,096	3,133,096
Capital Assets:			
Land	27,152	419,563	446,715
Infrastructure, net	-	33,580,539	33,580,539
Buildings, net	2,108,574	10,000	2,118,574
Machinery and Equipment, net	1,102,267	1,070,480	2,172,747
Accumulated Depreciation	(1,312,073)	(13,969,226)	(15,281,299)
Construction in Progress	-	585,320	585,320
Total Assets	<u>6,170,878</u>	<u>28,409,642</u>	<u>34,580,520</u>
<b>LIABILITIES</b>			
Accounts Payable and other current liabilities	16,668	44,744	61,412
Intergovernmental Payable	1,805	2,812	4,617
Accrued Interest Payable	-	147,000	147,000
Deferred Revenues	12,672	200,856	213,528
Notes Payable - Current	-	2,500,000	2,500,000
Deposits	142,014	185,684	327,698
Noncurrent Liabilities			
Due in More Than One Year	-	7,500,000	7,500,000
Total Liabilities	<u>173,159</u>	<u>10,581,096</u>	<u>10,754,255</u>
<b>NET ASSETS</b>			
Invested in Capital Assets, Net of Related Debt	1,925,920	11,696,676	13,622,596
Restricted for Debt Service	-	3,133,096	3,133,096
Unrestricted Net Assets	4,071,799	2,998,774	7,070,573
Total Net Assets	<u>\$ 5,997,719</u>	<u>\$ 17,828,546</u>	<u>\$ 23,826,265</u>

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Program Revenues		
Expenses	Charges for Services	Capital Grants and Contributions	
<b>Primary Government:</b>			
GOVERNMENTAL ACTIVITIES:			
General Government	\$ 468,447	\$ 160,590	\$ -
Police	1,044,326	12,231	-
Fire Protection	1,066,187	103,949	54,000
Development Services	119,611	-	-
Total Governmental Activities:	2,698,571	276,770	54,000
BUSINESS-TYPE ACTIVITIES:			
Utility Fund	5,479,152	4,172,211	-
Total Business-Type Activities:	5,479,152	4,172,211	-
<b>TOTAL PRIMARY GOVERNMENT:</b>	<b>\$ 8,177,723</b>	<b>\$ 4,448,981</b>	<b>\$ 54,000</b>

General Revenues:

Taxes:

Property Taxes, Levied for General Purposes

Other Taxes

Penalty and Interest

Grants and Contributions Not Restricted

Miscellaneous Revenue

Investment Earnings

Transfers In (Out)

Total General Revenues and Transfers

Change in Net Assets

Net Assets--Beginning

Net Assets--Ending

The notes to the Financial Statements are an integral part of this statement.

Net (Expense) Revenue and Changes in Net Assets		
Primary Government		
Governmental Activities	Business-type Activities	Total
\$ (307,857)	\$ -	\$ (307,857)
(1,032,095)	-	(1,032,095)
(908,238)	-	(908,238)
(119,611)	-	(119,611)
<u>(2,367,801)</u>	<u>-</u>	<u>(2,367,801)</u>
-	(1,306,941)	(1,306,941)
-	(1,306,941)	(1,306,941)
<u>(2,367,801)</u>	<u>(1,306,941)</u>	<u>(3,674,742)</u>
4,825,754	-	4,825,754
85,938	-	85,938
48,941	-	48,941
3,605	-	3,605
59,395	6,714	66,109
238,620	292,465	531,085
<u>(1,560,000)</u>	<u>1,560,000</u>	<u>-</u>
<u>3,702,253</u>	<u>1,859,179</u>	<u>5,561,432</u>
1,334,452	552,238	1,886,690
<u>4,663,267</u>	<u>17,276,308</u>	<u>21,939,575</u>
<u>\$ 5,997,719</u>	<u>\$ 17,828,546</u>	<u>\$ 23,826,265</u>

CITY OF HORSESHOE BAY  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
SEPTEMBER 30, 2007

	General Fund
<hr/>	
ASSETS	
Cash and Cash Equivalents	\$ 31,503
Investments - Current	4,054,716
Taxes Receivable	126,718
Allowance for Uncollectible Taxes (credit)	(6,336)
Receivables (net of allowance for uncollectibles)	13,598
Prepaid Items	20,601
Total Assets	<u>\$ 4,240,800</u>
LIABILITIES AND FUND BALANCES	
Liabilities:	
Accounts Payable	\$ 16,668
Intergovernmental Payable	1,805
Deferred Revenues	120,382
Other Current Liabilities	142,014
Total Liabilities	<u>280,869</u>
Fund Balances:	
Unreserved and Undesignated:	
Reported in the General Fund	<u>3,959,931</u>
Total Fund Balances	<u>3,959,931</u>
Total Liabilities and Fund Balances	<u>\$ 4,240,800</u>

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
 RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE  
 STATEMENT OF NET ASSETS  
 SEPTEMBER 30, 2007

<b>Total Fund Balances - Governmental Funds</b>	\$	3,959,931
Capital assets used in governmental activities are not financial resources and therefore are not reported in governmental funds. At the beginning of the year, the cost of these assets was \$3,098,533 and the accumulated depreciation was \$1,080,683. In addition, long-term liabilities, including bonds payable, are not due and payable in the current period, and, therefore are not reported as liabilities in the funds. The net effect of including the beginning balances for capital assets (net of depreciation) and long-term debt in the governmental activities is to increase net assets.		2,017,850
Current year capital outlays and long-term debt principal payments are expenditures in the fund financial statements, but they should be shown as increases in capital assets and reductions in long-term debt in the government-wide financial statements. The net effect of including the 2007 capital outlays and debt principal payments is to increase net assets.		139,460
The 2007 depreciation expense increases accumulated depreciation. The net effect of the current year's depreciation is to decrease net assets.		(231,390)
Various other reclassifications and eliminations are necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. These include recognizing deferred revenue as revenue, eliminating interfund transactions, reclassifying the proceeds of bond sales as an increase in bonds payable, and recognizing the liabilities associated with maturing long-term debt and interest. The net effect of these reclassifications and recognitions is to increase net assets.		111,868
<b>Net Assets of Governmental Activities</b>	<b>\$</b>	<b>5,997,719</b>

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

EXHIBIT C-3

General  
Fund

REVENUES:

Taxes:		
Property Taxes	\$	4,817,089
Other Taxes		85,938
Penalty and Interest on Taxes		48,941
Licenses and Permits		160,590
Intergovernmental Revenue and Grants		54,000
Charges for Services		103,949
Fines		12,231
Investment Earnings		238,620
Rents and Royalties		9,636
Contributions & Donations from Private Sources		3,605
Other Revenue		45,601
		5,580,200
Total Revenues		5,580,200

EXPENDITURES:

Current:		
General Government		428,762
Public Safety:		
Police		954,716
Fire Protection		974,632
Public Works:		
Development Services		109,071
Capital Outlay:		
Capital Outlay		139,460
		2,606,641
Total Expenditures		2,606,641
Excess of Revenues Over Expenditures		2,973,559

OTHER FINANCING SOURCES (USES):

Transfers Out (Use)		(1,560,000)
		(1,560,000)
Total Other Financing Sources (Uses)		(1,560,000)
Net Change in Fund Balances		1,413,559
Fund Balance - October 1 (Beginning)		2,546,372
Fund Balance - September 30 (Ending)	\$	3,959,931

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
 RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES,  
 AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES  
 FOR THE YEAR ENDED SEPTEMBER 30, 2007

<b>Total Net Change in Fund Balances - Governmental Funds</b>	\$	1,413,559
Current year capital outlays and long-term debt principal payments are expenditures in the fund financial statements, but they should be shown as increases in capital assets and reductions in long-term debt in the government-wide financial statements. The net effect of removing the 2007 capital outlays and debt principal payments is to increase net assets.		139,460
Depreciation is not recognized as an expense in governmental funds since it does not require the use of current financial resources. The net effect of the current year's depreciation is to decrease net assets.		(231,390)
Various other reclassifications and eliminations are necessary to convert from the modified accrual basis of accounting to accrual basis of accounting. These include recognizing deferred revenue as revenue, adjusting current year revenue to show the revenue earned from the current year's tax levy, eliminating interfund transactions, reclassifying the proceeds of bond sales, and recognizing the liabilities associated with maturing long-term debt and interest. The net effect of these reclassifications and recognitions is to decrease net assets.		12,823
<b>Change in Net Assets of Governmental Activities</b>	<u>\$</u>	<u>1,334,452</u>

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF NET ASSETS  
PROPRIETARY FUNDS  
SEPTEMBER 30, 2007

	Business Type Activities
<b>ASSETS</b>	
<b>Current Assets:</b>	
Cash and Cash Equivalents	\$ 155,270
Investments - Current	2,882,994
Restricted Assets - Current:	
Note Debt Service	3,133,096
Accounts Receivable-Net of Uncollectible Allowance	470,171
Inventories	50,834
Prepaid Items	20,601
Total Current Assets	6,712,966
<b>Noncurrent Assets:</b>	
Capital Assets:	
Land Purchase and Improvements	419,563
Infrastructure	33,580,539
Buildings	10,000
Machinery and Equipment	1,070,480
Accumulated Depreciation - Capital Assets	(13,969,226)
Construction in Progress	585,320
Total Noncurrent Assets	21,696,676
Total Assets	28,409,642
<b>LIABILITIES</b>	
<b>Current Liabilities:</b>	
Accounts Payable	44,744
Intergovernmental Payable	2,812
Accrued Interest Payable	147,000
Deferred Revenue	200,856
Notes Payable - Current	2,500,000
Deposits	185,684
Total Current Liabilities	3,081,096
<b>NonCurrent Liabilities:</b>	
Notes Payable - Noncurrent	7,500,000
Total Noncurrent Liabilities	7,500,000
Total Liabilities	10,581,096
<b>NET ASSETS</b>	
Investments in Capital Assets, Net of Debt	11,696,676
Restricted for Debt Service	3,133,096
Unrestricted Net Assets	2,998,774
Total Net Assets	\$ 17,828,546

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

EXHIBIT D-2

	Business Type Activities
<hr/>	
OPERATING REVENUES:	
Charges for Water Services	\$ 2,183,341
Charges for Sewerage Service	1,333,203
Charges for Sanitation Service	554,535
Standby Charges	101,132
Other Revenue	6,714
Total Operating Revenues	4,178,925
OPERATING EXPENSES:	
Personal Services - Salaries and Wages	1,058,324
Personal Services - Employee Benefits	448,639
Purchased Professional & Technical Services	263,107
Purchased Property Services	1,823,961
Other Operating Expenses	275,129
Supplies	28,025
Depreciation	1,140,967
Total Operating Expenses	5,038,152
Operating Income (Loss)	(859,227)
NON-OPERATING REVENUES (EXPENSES):	
Investment Earnings	292,465
Interest Expense - Non-Operating	(441,000)
Total Non-operating Revenue (Expenses)	(148,535)
Income Before Transfers	(1,007,762)
Non-Operating Transfer In	1,560,000
Change in Net Assets	552,238
Total Net Assets - October 1 (Beginning)	17,276,308
 Total Net Assets - September 30 (Ending)	 \$ 17,828,546

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Business Type Activities
<hr/>	
<u>Cash Flows from Operating Activities:</u>	
Cash Received from User Charges	\$ 4,099,796
Cash Received from Assessments - Standby Charges	90,070
Cash Payments to Employees for Services	(1,506,963)
Cash Payments for Suppliers	(1,936,699)
Cash Payments for Other Operating Expenses	(500,004)
Net Cash Provided by Operating Activities	<u>246,200</u>
<u>Cash Flows from Non-Capital Financing Activities:</u>	
Operating Transfer In	<u>1,560,000</u>
<u>Cash Flows from Capital &amp; Related Financing Activities:</u>	
Acquisition of Capital Assets	(1,199,655)
Use of Restricted Assets	42,523
Interest Paid	(441,000)
Net Cash Provided by (Used for) Capital & Related Financing Activities	<u>(1,598,132)</u>
<u>Cash Flows from Investing Activities:</u>	
Interest and Dividends on Investments	<u>292,466</u>
Net Increase in Cash and Cash Equivalents	500,534
Cash and Cash Equivalents at Beginning of the Year:	<u>2,537,730</u>
Cash and Cash Equivalents at the End of the Year:	<u><u>\$ 3,038,264</u></u>

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Business Type Activities
<hr/>	
<u>Reconciliation of Operating Income (Loss) to Net Cash Provided By Operating Activities:</u>	
Operating Income (Loss):	\$ (859,227)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	1,140,967
Effect of Increases and Decreases in Current Assets and Liabilities:	
Decrease (increase) in Receivables	(16,964)
Decrease (increase) in Inventories	55,637
Decrease (increase) in Prepaid Expenses	38,232
Increase (decrease) in Accounts Payable	(140,352)
Increase (decrease) in Deposits	38,969
Increase (decrease) in Deferred Revenues	(11,062)
Net Cash Provided by Operating Activities	\$ 246,200

The notes to the Financial Statements are an integral part of this statement.

CITY OF HORSESHOE BAY, TEXAS  
NOTES TO THE FINANCIAL STATEMENTS  
SEPTEMBER 30, 2007

NOTE I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Horseshoe Bay, Texas, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The *Government Accounting Standards Board* (GASB) is the accepted standard-setting body for establishing government accounting and financial reporting principles. The more significant of the City's accounting policies are described below:

A. Creation of the City

At a special election held on September 10, 2005, voters approved incorporation of the City of Horseshoe Bay as a Type A, General-Law-Municipality. At a special election held on November 8, 2005, voters elected a mayor and five aldermen. In January, 2006, the City approved a strategic partnership agreement with the Lake LBJ Municipal Utility District. Pursuant to the terms of the agreement, on March 1, 2006, the City annexed the Lake LBJ Municipal Utility District. All assets, liabilities and equity of the District were transferred to the City and the District was subsequently dissolved.

B. Reporting Entity

In evaluating how to define the government, for financial purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Statement 14. The definition of the reporting entity is based primarily on the concept of financial accountability. A primary government is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. Based on the foregoing criteria, there were no component units identified that would require inclusion in this report.

C. Government-Wide and Fund Financial Statements

The Statement of Net Assets and the Statement of Activities are government-wide financial statements. They report information on all of the City of Horseshoe Bay nonfiduciary activities with most of the interfund activities removed. *Governmental activities* include programs supported primarily by taxes, sales tax, franchise tax, municipal court fines, charges for services and other miscellaneous revenues. *Business-type activities* include operations that rely to a significant extent on fees and charges for services.

The Statement of Activities demonstrates how other people or entities that participate in programs the City operates have shared in the payment of the direct costs. The "charges for services" column includes payments made by parties that purchase, use, or directly benefit from goods or services provided by a given function or segment of the City.

Interfund activities between governmental funds appear as due to/due froms on the Governmental Fund Balance Sheet and as other resources and other uses on the governmental fund Statement of Revenues, Expenditures and Changes in Fund Balance. All interfund transactions between governmental funds are eliminated on the government-wide statements. Interfund activities between governmental funds and fiduciary funds remain as due to/due froms on the government-wide Statement of Activities.

The fund financial statements provide reports on the financial condition and results of operations for two fund categories - governmental and proprietary. The City considers some governmental funds major and reports their financial condition and results of operations in a separate column.

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

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

The government-wide financial statements use the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements use the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets, current liabilities and fund balances are included on the balance sheet. Operating statements of these funds present net increases and decreases in current assets (i.e. revenues and other financing sources and expenditures and other financing uses).

The modified accrual basis of accounting recognizes revenues in the accounting period in which they become both measurable and available, and it recognizes expenditures in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest and principal on long-term debt, which is recognized when due. The expenditures related to certain compensated absences and claims and judgments are recognized when the obligations are expected to be liquidated with expendable available financial resources. The City considers all revenues available if they are collectible within 60 days after year end.

Revenues from local sources consist primarily of property taxes. Property tax revenues and revenues received from the State are recognized under the "susceptible to accrual" concept; that is, when they are both measurable and available. The City considers them "available" if they will be collected within 60 days of the end of the fiscal year. Miscellaneous revenues are recorded as revenue when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available.

Grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant. Accordingly, when such funds are received, they are recorded as deferred revenues until related and authorized expenditures have been made. If balances have not been expended by the end of the project period, grantors some times require the City to refund all or part of the unused amount.

E. Fund Accounting

The City reports the following major governmental funds:

1. **The General Fund** - The general fund is the City's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.

Proprietary Fund:

1. **Enterprise Fund** - The Water Utility Fund is operated as an Enterprise Fund.

F. Other Accounting Policies

1. In the government-wide financial statements in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

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

2. Capital assets, which include land, buildings, furniture and equipment are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Buildings, furniture and equipment of the City are depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Infrastructure	20-40
Buildings	30
Improvements	30
Equipment	7
Vehicles	5

Pursuant to GASB Statement Number 34, an extended period of deferral is available before the requirement to record and depreciate infrastructure assets (e.g., roads, bridges, and similar items) acquired before the implementation date becomes effective.

3. In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.
4. When the City incurs an expense for which it may use either restricted or unrestricted assets, it uses the restricted assets first whenever they will have to be returned if they are not used.
5. The original budget is adopted by the City Council prior to the beginning of the fiscal year through passage of an ordinance. The budget includes proposed expenditures and the means of financing them.

Budgeted amounts for expenditures from the various funds may not exceed the beginning balances of those funds plus the anticipated revenues for the fiscal year. The final amended budget has been presented in this report. Unencumbered appropriations lapse at the end of each year.

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

## NOTE II. DETAILED NOTES ON ALL FUNDS AND ACCOUNT GROUPS

### A. DEPOSITS AND INVESTMENTS

#### Legal and Contractual Provisions Governing Deposits and Investments

The funds of the City must be deposited and invested under the terms of a contract, contents of which are set out in the **Depository Contract Law**. The depository bank places approved pledged securities for safekeeping and trust with the City's agent bank in an amount sufficient to protect City funds on a day-to-day basis during the period of the contract. The pledge of approved securities is waived only to the extent of the depository bank's dollar amount of Federal Deposit Insurance Corporation ("FDIC") insurance.

At September 30, 2007, the carrying amount of the City's deposits was \$186,123 and the bank balance was \$477,212.

The **Public Funds Investment Act** (Government Code Chapter 2256) contains specific provisions in the areas of investment practices, management reports and establishment of appropriate policies. Among other things, it requires the City to adopt, implement, and publicize an investment policy. That policy must address the following areas: (1) safety of principal and liquidity, (2) portfolio diversification, (3) allowable investments, (4) acceptable risk levels, (5) expected rates of return, (6) maximum allowable stated maturity of portfolio investments, (7) maximum average dollar-weighted maturity allowed based on the stated maturity date for the portfolio, (8) investment staff quality and capabilities, (9) and bid solicitation preferences for certificates of deposit. Statutes authorize the City to invest in (1) obligations of the U.S. Treasury, certain U.S. agencies, and the State of Texas; (2) certificates of deposit, (3) certain municipal securities, (4) money market savings accounts, (5) repurchase agreements, (6) bankers acceptances, (7) mutual funds, (8) investment pools, (9) guaranteed investment contracts, (10) and common trust funds. The Act also requires the City to have independent auditors perform test procedures related to investment practices as provided by the Act. The City is in substantial compliance with the requirements of the Act and with local policies.

The carrying value of investments at September 30, 2007 was \$10,070,806 (Texpool Investment Pool). Local government investment pools operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. Local government investment pools use amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in these pools is the same as the value of the shares in each pool.

#### Policies Governing Deposits and Investments

In compliance with the **Public Funds Investment Act**, the City has adopted a deposit and investment policy. That policy does address the following risks:

**Custodial Credit Risk - Deposits:** This is the risk that in the event of bank failure, the City's deposits may not be returned to it. The City was not exposed to custodial credit risk since its deposits at year-end and during the year ended September 30, 2007 were covered by depository insurance or by pledged collateral held by the City's agent bank in the City's name.

**Custodial Credit Risk - Investments:** 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. Investments are subject to custodial credit risk only if they are evidenced by securities that exist in physical or book entry form. Thus positions in external investment pools are not subject to custodial credit risk because they are not evidenced by securities that exist in physical or book entry form.

**Other Credit Risk:** There is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. To minimize credit risk, Texpool Investment Pool invests only in investments authorized under the Public Funds Investment Act. TexPool's portfolio has low market (credit) risk due to restrictions on weighted average maturity and maximum maturity of any one investment. The investment manager is required to maintain a stable \$1.00 net asset value and must take immediate action if the net asset value of the portfolio falls below \$.995 or rises above \$1.005.

B. 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 located in the City 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. On January 31 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed. Property tax revenues are considered available (1) when they become due or past due and receivable within the current period and (2) when they are expected to be collected during a 60-day period after the close of the City fiscal year.

The City contracted with the Llano County Appraisal District for the appraisal and with Llano County for the collection of taxes. For the 2006 tax roll, the assessed valuation was \$963,729,800 and the tax rate was \$.50 per \$100 valuation (general fund only).

C. Restricted Assets

Restricted assets in the Water Utilities Fund represent cash that has been set aside for future payment of revenue bonds and capital improvements. A summary of restricted assets at September 30, 2007 appears below:

Texpool Investments -	
Note Debt Service	2,508,096
Operating Reserve	625,000
Total Restricted Assets	<u>\$ 3,133,096</u>

D. Property, Plant and Equipment

A summary of changes in property, plant and equipment accounts in the Water Utilities Fund follows:

	Balance 10/1/06	Additions	Deletions	Balance 9/30/07
Land	\$ 419,563	\$	\$	\$ 419,563
Infrastructure	22,359,411	11,221,128		33,580,539
Machinery and Equipment	932,077	138,403		1,070,480
Buildings & Improvements	10,000			10,000
Construction in Progress	10,745,196		10,159,876	585,320
	<u>\$ 34,466,247</u>	<u>\$ 11,359,531</u>	<u>\$ 10,159,876</u>	<u>\$ 35,665,902</u>
Less: Accumulated Depreciation	(12,828,260)	(1,140,966)		(13,969,226)
Fixed Assets, net	<u>\$ 21,637,987</u>	<u>\$ 10,218,565</u>	<u>\$ 10,159,876</u>	<u>\$ 21,696,676</u>

E. Capital Asset Activity

Capital asset activity for the City for the year ended September 30, 2007, was as follows:

	Primary Government			
	Beginning Balance	Additions	Retirements	Ending Balance
Governmental Activities:				
Land	\$ 27,152	\$	\$	\$ 27,152
Machinery & Equipment	976,679	125,588		1,102,267
Buildings & Improvements	2,094,702	13,872		2,108,574
Totals at Historic Cost	\$ 3,098,533	\$ 139,460	\$	\$ 3,237,993
Less Accumulated Depreciation	\$ (1,080,683)	\$ (231,390)	\$	\$ (1,312,073)
Governmental Activities Capital Assets, Net	\$ 2,017,850	\$ (91,930)	\$	\$ 1,925,920

F. Revenue Notes Payable

	Outstanding 10/1/06	Issued	Retired	Outstanding 9/30/07	Due Within One Year
<i>Waterworks &amp; Sewer System Revenue Notes -</i>					
Series 2004 (interest rate 4.41%)	\$ 10,000,000	\$	\$	\$ 10,000,000	\$ 2,500,000
Totals	\$ 10,000,000	\$	\$	\$ 10,000,000	\$ 2,500,000

The annual requirements to amortize the certificates of obligation and bonds outstanding at September 30, 2007 for the next five fiscal years follows:

September 30,	Principal	Interest	Total
2008	\$ 2,500,000	\$ 385,875	\$ 2,885,875
2009		330,750	330,750
2010	2,500,000	275,625	2,775,625
2011		220,500	220,500
2012	2,500,000	165,375	2,665,375
2013 - 2016	2,500,000	275,625	2,775,625
Totals	\$ 10,000,000	\$ 1,653,750	\$ 11,653,750

The Waterworks and Sewer System Revenue Notes Series 2004, were issued to finance water system improvements. The notes may be redeemed at any time subject only to a prepayment fee if redeemed before November 17, 2007. The debt agreement contains the requirements for an operating reserve and a note debt service fund. The City is required to maintain an operating reserve equal to two month's average maintenance and operating expenses. The City is also required to deposit in equal monthly installments into the note debt service fund an amount to accumulate a balance equal to the maturing principal and interest on the notes.

The provisions of the bond resolutions relating to debt service requirements have been met and the cash allocated for these purposes is sufficient to meet upcoming debt service requirements.

G. Risk Management

The City of Horseshoe Bay is exposed to various risks of loss relating to general liability, accidental loss of real and personal property, damage to assets, errors and omissions, acts of God and personnel risks which relate to workers compensation.

The City contracts with the Texas Municipal League (TML) to provide insurance coverage for identified risks. TML is a multi-government group that provides for a combination of modified self-insurance and stop-loss coverage. Contributions are sent annually to TML. Liability by the City is generally limited to the contributed amounts. Contributions for the year ended September 30, 2007 were \$51,363.

H. Retirement Plan

In addition to Social Security, a retirement plan is available for those individuals who have been employed by the City over one year. The City pays 5% of the individual's base salary not including overtime to the plan if they have been with the City under five years and 7.5% of base salary not including overtime if they have been employed over five years. After one year of continuous employment, the City will match each employee's contribution in an amount not to exceed 5% of the employee's regular base salary, not including overtime. The plan is administered by Nationwide Retirements Solutions, Inc. A copy of the annual report is available for review at the City office.

A summary of transactions is shown below:

Beginning balance	\$	576,511
Contributions		148,872
Investment earnings		102,665
Withdrawals		(50,132)
Fees		<u>(5,372)</u>
Ending balance	\$	<u><u>772,544</u></u>

I. Employee Insurance Benefits

All regular full time employees of the city are eligible for coverage under the group medical program provided by the city through Blue Cross-Blue Shield of Texas. The city pays the premium for eligible employees and employees, at their option, may authorize payroll withholdings to pay premiums for eligible family members.

J. Cash Flows Statement - Supplemental Disclosure

Since the City is tax exempt, no income tax was paid in 2007. The City paid interest in the amount of \$441,000 in 2007 on their outstanding debt.

K. Claims and Contingent Liabilities

Amounts received or receivable from grantor 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 amount, if any, 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.

L. Subsequent Event

Subsequent to the audit period, the City refunded the Series 2004 Revenue Notes by issuing \$7,500,000 General Obligation Refunding Bonds, Series 2007.

CITY OF HORSESHOE BAY  
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE  
BUDGET AND ACTUAL - GENERAL FUND  
FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Budgeted Amounts		Actual Amounts (GAAP BASIS)	Variance With Final Budget Positive or (Negative)
	Original	Final		
<b>REVENUES:</b>				
Taxes:				
Property Taxes	\$ 4,674,090	\$ 4,674,090	\$ 4,817,089	\$ 142,999
Other Taxes	35,000	35,000	85,938	50,938
Penalty and Interest on Taxes	51,732	51,732	48,941	(2,791)
Licenses and Permits	100,000	100,000	160,590	60,590
Intergovernmental Revenue and Grants	-	54,000	54,000	-
Charges for Services	108,500	108,500	103,949	(4,551)
Fines	50,000	50,000	12,231	(37,769)
Investment Earnings	150,100	150,100	238,620	88,520
Rents and Royalties	9,696	9,696	9,636	(60)
Contributions & Donations from Private Sources	1,500	1,500	3,605	2,105
Other Revenue	35,398	35,398	45,601	10,203
Total Revenues	5,216,016	5,270,016	5,580,200	310,184
<b>EXPENDITURES:</b>				
Current:				
General Government	575,288	513,025	428,762	84,263
Public Safety:				
Police	961,641	961,641	954,716	6,925
Fire Protection	940,975	974,974	974,632	342
Public Works:				
Development Services	96,000	110,000	109,071	929
Capital Outlay:				
Capital Outlay	135,100	189,100	139,460	49,640
Total Expenditures	2,709,004	2,748,740	2,606,641	142,099
Excess (Deficiency) of Revenues Over (Under) Expenditures	2,507,012	2,521,276	2,973,559	452,283
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers Out (Use)	(1,566,323)	(1,566,323)	(1,560,000)	6,323
Total Other Financing Sources (Uses)	(1,566,323)	(1,566,323)	(1,560,000)	6,323
Net Change	940,689	954,953	1,413,559	458,606
Fund Balance - October 1 (Beginning)	2,546,372	2,546,372	2,546,372	-
Fund Balance - September 30 (Ending)	\$ 3,487,061	\$ 3,501,325	\$ 3,959,931	\$ 458,606

The accompanying notes are an integral part of this statement.

# *NEFFENDORF, KNOPP, HORRY & DOSS, P.C.*

*Certified Public Accountants*

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

### Independent Auditor's Report

Honorable Mayor and Aldermen  
City of Horseshoe Bay, Texas  
Horseshoe Bay, TX 78657

We have audited the financial statements of City of Horseshoe Bay as of and for the year ended September 30, 2007, and have issued our report thereon dated March 5, 2008.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### Compliance

As part of obtaining reasonable assurance about whether City of Horseshoe Bay's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered City of Horseshoe Bay's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the administration of City of Horseshoe Bay in a separate letter dated March 5, 2008.

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

NEFFENDORF, KNOPP, HORRY & DOSS, P.C.  
Fredericksburg, Texas

March 5, 2008

# *NEFFENDORF, KNOPP, HORRY & DOSS, P.C.*

## *Certified Public Accountants*

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MEMBER  
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CERTIFIED PUBLIC ACCOUNTANTS

March 5, 2008

Honorable Mayor and Aldermen  
City of Horseshoe Bay, Texas  
Horseshoe Bay, TX 78657

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Horseshoe Bay for the year ended September 30, 2007, and have issued our report thereon dated March 5, 2008. Professional standards require that we provide you with the following information related to our audit.

### Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

### Significant Audit Findings

#### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by City of Horseshoe Bay are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2007. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

#### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing our audit.

#### *Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

*Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

*Management Representations*

We have requested certain representations from management that are included in the management representation letter dated March 5, 2008.

*Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

*Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the City Council and management of City of Horseshoe Bay and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

NEFFENDORF, KNOPP, HORRY AND DOSS, P.C.  
Fredericksburg, Texas